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A 14-PAGE SPECIAL REPORT ON CHINA'S THIRST FOR RESOURCES

PRINT EDITION

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Politics this week

Mar 13th 2008
From The Economist print edition

AFP

Malaysia's ruling National Front suffered its biggest electoral setback since independence in 1957. Though the coalition returned to power, it lost the two-thirds majority in Parliament it has enjoyed since 1969 and held onto only eight of Malaysia's 13 state governments. In one state, Penang, the opposition said it would no longer follow the New Economic Policy that discriminates in favour of the country's ethnic Malays. See article

In **Pakistan**, Asif Zardari, leader of the Pakistan People's Party, signed a power-sharing agreement with Nawaz Sharif of the Pakistan Muslim League-Nawaz. Both parties agreed to rule in co-operation at the federal level and in Punjab, the country's richest province. Meanwhile, at least 24 people were killed in two suicide-bomb attacks in **Lahore**. One attack occurred at the entrance to the offices of the Federal Investigation Agency. See article

Tibetans began demonstrations on the anniversary of an uprising against Chinese rule. Chinese police dispersed monks marching in Lhasa, using tear-gas, and India ordered Tibetans to stop a march from their home in exile, Dharamsala, towards the border. See article

Hong Kong closed all its kindergartens and junior schools after the outbreak of an unidentified flu-like illness, which has killed four children and affected 200 others.

As expected, **China** announced the creation of five “super-ministries” to streamline decision-making. This entails a new ministry for the environment, but not an energy ministry, the subject of bureaucratic opposition.

Blossoming in Madrid

AFP

The Socialists won **Spain's** general election. José Luis Rodríguez Zapatero will serve as prime minister for another four years, but he did not win an absolute majority, so will depend on support from one or more regional parties to form a government. See article

Serbia's government fell, precipitating a fresh general election in May. The prime minister, Vojislav Kostunica, said the big election issues were Kosovo and Europe. See article

Three former **Croatian generals**, including Ante Gotovina, went on trial before a war-crimes tribunal in The Hague, charged with the persecution and murder of Croatian Serbs in the mid-1990s.

Hungary's government lost a referendum, promoted by the opposition, to scrap fees for health care and higher education. The government will now have to find some other ways of plugging its gaping budget deficit.

The first round of **France's** municipal elections saw a sharp swing from the centre-right party of President Nicolas Sarkozy towards his Socialist opponents. The second round is on March 16th.

On a different page

Admiral William Fallon, America's top commander in the **Middle East**, announced his retirement after a magazine ran a profile citing apparent policy disagreements with the Bush administration over Iran and

other issues. Robert Gates, the defence secretary, said speculation linking the retirement with a putative attack on Iran was “ridiculous”.

Iranians prepared to vote on March 14th in elections to the *majlis*, or parliament. Most reformist candidates have been excluded and it has become a contest between those conservatives who support President Mahmoud Ahmadinejad and a more pragmatic bunch who oppose him.

Uganda's president, Yoweri Museveni, said leaders of the rebel Lord's Resistance Army, responsible for horrific brutality over the past 22 years, should not be judged by the International Criminal Court in The Hague. Instead, he recommended trial in Uganda, emphasising compensation for the victims rather than retribution. See article

The power-sharing agreement signed last month to end two months of violence in **Kenya** came under threat after the head of the civil service said that, as prime minister under the pact, opposition leader Raila Odinga would have less power than President Mwai Kibaki and his vice-president. A spokesman for Mr Odinga, who is demanding executive powers, said reducing him to “a minor hanger-on” would be a “deal-breaker”. See article

Ring of fire

AP

Eliot Spitzer resigned as the governor of New York state after it emerged he had been the client of a high-class prostitution ring, which shocked even the most grizzled of political veterans. Mr Spitzer won election in 2006 following a career as a federal and state prosecutor, during which he pursued Wall Street banks for ethical violations and prosecuted organised-crime families with equal vigour. See article

Barack Obama won Mississippi's primary and Wyoming's caucus by wide margins in the last stage of the Democratic presidential nomination process before Pennsylvanians vote on April 22nd. With neither Mr Obama nor Hillary Clinton likely to reach the required number of pledged delegates regardless, the party started a furious debate about how it was going to decide upon its eventual presidential candidate. See article

In a special election, the Democrats picked up a congressional seat in Illinois that had been held for 22 years by **Dennis Hastert**, the former speaker, who stepped down from Congress last year. With Republicans retiring from the House in droves, the Democrats seem well placed to keep their majority in November. See article

George Bush vetoed a bill that would have limited the CIA's interrogation techniques to the 19 described in the army's field manual and in the process outlawed “**waterboarding**”, which simulates drowning and which critics say amounts to torture. John McCain, the Republicans' presidential candidate, has long opposed the use of waterboarding, but he also opposes the bill because he does not want to “restrict” the CIA to the field manual.

Their days are numbered

Canada said that hunters can kill 275,000 harp seals and 8,200 hooded seals during the 2008 Atlantic seal hunt, expected to begin later this month. New measures aimed at making the hunt more humane and staving off European trade sanctions are set to begin this year.

A week after going to the brink of war, the presidents of **Colombia**, **Venezuela** and **Ecuador** kissed and made up on television. But their love-in is not expected to last long. See article

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Business this week

Mar 13th 2008
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America's **Federal Reserve** intervened twice in the markets to boost liquidity. On March 7th it promised to provide up to $200 billion in temporary loans to banks and bond-market dealers. And on March 11th the Fed promised to lend up to $200 billion of Treasury bonds for a month at a time, accepting mortgage-backed securities as collateral. Other central banks announced more modest measures. Stockmarkets rallied, but some analysts wondered if yet more action wouldn't be required. Meanwhile, Hank Paulson, the treasury secretary, was due to outline new regulations for the mortgage industry to alleviate some of the problems that led to the credit crisis. See article

Payroll employment in America fell by 63,000 in February, the biggest monthly drop in nearly five years. Almost all employment sectors shed jobs, with the biggest declines in manufacturing and construction. However, the addition of 38,000 government workers to the payrolls stopped the total figure from being even worse.

The **dollar** dropped to a record low of $1.55 against the **euro** as investors speculated that the Fed would slash interest rates again. The dollar also fell to a 12-year low against the **yen**, below the ¥100 level.

High society

Société Générale announced that its *euro*5.5 billion ($8.5 billion) share issue was massively oversubscribed. The French bank tendered the offer to bolster its capital after losses that arose from a huge rogue-trading scandal (in which another bank employee was detained briefly). SocGen will hope its new riches can dissuade other banks from trying to buy it, though the prospect of an auction may be precisely why investors wanted its shares.

A mortgage-bond fund affiliated to **Carlyle Group**, a private-equity firm, said it was close to collapse after its lenders moved to seize assets amid the fund's financial woes. The fund dealt only in mortgage-backed securities with top-notch credit-ratings, and not the subprime market, indicating how far the credit crisis has spread.

With credit markets paralysed and the enthusiasm for acquisitions dampened, **Blackstone Group's** quarterly revenue tumbled, to $345m from $1.3 billion a year earlier. The buy-out firm has seen its share price fall by half since its initial public offering last June. See article

Fasten your seat-belts

Southwest Airlines grounded 38 of its jets in response to the Federal Aviation Administration's claim that the company had operated flights using aircraft that missed safety checks for structural cracks. The budget carrier faces a $10.2m civil penalty and has placed three employees on leave.

Boeing lodged a complaint against the American air force's decision to award a $35 billion contract for new flying tankers to a joint project from **Northrop Grumman** and **EADS**. Boeing argues that its tanker is less risky and costly than its rival's and that the air force's evaluation process was flawed. Some American politicians are angry that EADS, a European company, should be given a slice of such a big defence deal.

Meanwhile, EADS reported its first annual net loss in five years, of *euro*446m ($588m), on the back of production delays at **Airbus**, its largest subsidiary. The weak dollar also hurt Airbus, lopping $1.1 billion off its revenues (aircraft are traded in the currency).

Google completed its takeover of **DoubleClick**, first announced last April, after the EU's competition commissioner gave her approval. The deal solidifies Google's lead in online advertising; rivals, such as Microsoft, had raised objections. America's regulators gave the merger their blessing three months ago.

The upper house in Japan's Diet rejected the government's choice of Toshiro Muto as governor of the **Bank of Japan**, leaving it somewhat in limbo. The central bank's present governor, Toshihiko Fukui, retires on March 19th. Japan's upper house is controlled by opposition parties, which think Mr Muto's former career as a top civil-servant in the finance ministry ties him too closely to the ruling party.

Having a blast

Incitec Pivot, which makes fertilisers, made a bid for **Dyno Nobel**, a dynamite-maker, valuing its Australian compatriot at A$3.3 billion ($3 billion). Its business is booming partly because of the demand for explosives from companies mining for metals and other commodities.

Alistair Darling unveiled his first budget since becoming Britain's chancellor last summer. In addition to sin taxes on alcohol and tobacco, Mr Darling proposed to introduce a charge on **plastic bags** in 2009 if voluntary action by supermarkets did not reduce their circulation. See article

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KAL's cartoon

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Illustration by Kevin Kallaugher

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China

The new colonialists

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China's hunger for natural resources is causing more problems at home than abroad

THERE is no exaggerating China's hunger for commodities. The country accounts for about a fifth of the world's population, yet it gobbles up more than half of the world's pork, half of its cement, a third of its steel and over a quarter of its aluminium. It is spending 35 times as much on imports of soya beans and crude oil as it did in 1999, and 23 times as much importing copper—indeed, China has swallowed over four-fifths of the increase in the world's copper supply since 2000.

What is more, China is getting ever hungrier. Although consumption of petrol is falling in America, the oil price is setting new records, because demand from China and other developing economies is still on the rise. The International Energy Agency expects China's imports of oil to triple by 2030. Chinese demand for raw materials of all sorts is growing so fast and creating such a bonanza for farmers, miners and oilmen that phrases such as “bull market” or “cyclical expansion” do not seem to do it justice (see special report). Instead, bankers have coined a new word: supercycle.

Not all observers, however, think that China's unstinting appetite for commodities is super. The most common complaint centres on foreign policy. In its drive to secure reliable supplies of raw materials, it is said, China is coddling dictators, despoiling poor countries and undermining Western efforts to spread democracy and prosperity. America and Europe, the shrillest voices say, are “losing” Africa and Latin America.

This argument ignores the benefits that China's commodities binge brings, not only to poor countries, but also to some rich ones, such as Australia. The economies of Africa and Latin America have never grown so fast. That growth, in turn, is likely to lift more people out of poverty than the West's faltering aid schemes. Moreover, China is not the only country to prop up brutish regimes. Witness the French troops scattered around Africa, some of whom recently delivered a shipment of Libyan arms to Chad's embattled strongman, Idriss Déby.

A new nuance

China could—and should—use its influence to curb the nastiest of its friends, including the governments of Sudan and Myanmar. And it is beginning to do so. It has ceased to resist the deployment of United Nations peacekeepers in Darfur, and is even sending some of its own military engineers to join the force. Wen Jiabao, China's prime minister, has called publicly for democracy in Myanmar—which, even though Chinese officials' understanding of democracy is different to Westerners', is a bold step for a government that claims not to meddle in other countries' internal affairs. The more business China does with the rest

of the world, the more nuanced its foreign policy is likely to become.

Still, China's hunger for natural resources is creating plenty of problems. Most of them, though, are in China, not abroad.

China is hoovering up ever more commodities not just because its economy is growing so quickly, but also because that growth is concentrated in industries that use lots of resources. Over the past few years, there has been a marked shift from light manufacturing to heavy industry. So for each unit of output, China now consumes more raw materials.

That may sound like a minor change, but the implications are dramatic. For one thing, it has encouraged the sort of foreign entanglements that are now causing China such embarrassment. More worryingly, it is compounding China's already grim pollution. Heavy industry requires huge amounts of power. Steelmaking, for example, uses 16% of China's power, compared with 10% for all the country's households combined. By far the most common fuel for power generation is coal. So more steel mills and chemical plants mean more acid rain and smog, not to mention global warming.

These are not just inconveniences, but also an enormous drag on society. Each year, they make millions sick, cause hundreds of thousands of premature deaths, sap agricultural yields and so on. Pan Yue, a deputy minister at the government's environmental watchdog, believes that the costs inflicted by pollution each year amount to some 10% of GDP.

No fire without smoke

It is no wonder, then, that pollution is the cause of ever more protests and demonstrations. There were some 60,000 in 2006 alone, by the authorities' own count. Some are led not by impotent peasants but by well-organised burghers from Shanghai and Xiamen, a development that must horrify China's rulers. And the potential for even more disruptive environmental crises is great: northern China is already running out of water, and the glaciers that feed its dwindling rivers are melting, thanks to global warming.

The government is aware of these problems, and is trying to address them (see article). It has used this month's People's Congress to raise the status of Mr Pan's agency to a ministry. It has increased fines for pollution, reduced subsidies on fuels and scrapped tax breaks for heavy industry. It is also promoting cleaner sources of power, such as windmills and natural gas. Yet despite frantic efforts to clean up Beijing in time for the Olympics in August, athletes still doubt the air will be fit to breathe. The world's fastest marathon runner, for one, has threatened to drop out of that race because of pollution.

All the government's green schemes are being undermined by an artificial abundance of cheap capital, and by bureaucrats' enthusiasm for channelling it to grubby industries. Chinese banks, with the government's blessing, pay negative real interest on deposits and so can lend to state-owned firms very cheaply. Many of those firms also benefit from free land and pay negligible dividends to the state, leaving lots of money to invest in more dirty factories. Chinese depositors and taxpayers are subsidising the very industries that are slowly poisoning them.

China is bound to consume enormous amounts of raw materials as it develops. But given how polluted the country already is, and how much unrest that pollution is causing, it should curb its hunger for resources. A less wasteful development strategy would be a healthier one.

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Tax

Not now, Darling

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Britain has botched the taxation of its rich foreigners

Illustration by Claudio Munoz

IT TAKES special ineptitude to cheapen a principle without getting anything much in return. But this week, in a do-nothing budget devoted to plastic bags and cavity-wall insulation (see article), Alistair Darling, Britain's hapless chancellor of the exchequer, showed he is equal to the task. Mr Darling confirmed his plan to change the taxation of rich foreigners living in Britain so as to make it fair. Equity—particularly the idea that people with similar incomes should pay similar tax—is a good basis for taxation, yet the government's reform is such a catalogue of blunders, muddled thinking and unknowable consequences that it ought not to have been proposed at all.

Britain has roughly 114,000 people claiming non-domiciled status. Until recently Britons probably thought "non-dom" belonged to the bizarre shorthand of lonely-hearts columns. But City financiers grew wealthier and voters think they have rumbled an injustice: Britain welcomes very rich people who get away without paying their share of tax.

Non-doms pay tax on the income they earn in Britain and the income they bring into the country, but not on the income they leave abroad. That raises about £4 billion ($8 billion) a year in income taxes. Britons, by contrast, are taxed on their worldwide income. Many countries tax foreigners posted abroad for a few years differently from the natives. But Britain's rules are generous and flawed. Non-doms and full taxpayers can be hard to tell apart. Astonishingly, because domicile can be "inherited", you may be non-dom even if you were born in Britain and have lived there your entire life. And the spirit of the rules is easily broken, by casting taxable foreign income and capital gains as untaxable foreign capital.

These flaws breach one of the three principles of sound taxation. As well as being simple and seeking not to distort the economy, taxation should be fair. A system that taxes similar people in similar situations different amounts distorts behaviour, offends against a sense of justice and thus undermines compliance. Britain's system fails the test.

But so does the government's remedy. Under the new system, non-doms will face a £30,000 annual fee after seven years if they want to keep their status. Many will still pay wildly different amounts from the family in the mansion next door. Nor will the exchequer benefit much. Even under the Treasury's assumptions, the reform will raise only £600m a year—loose change amid tax revenues of £600 billion.

The goose hisses

Even that may overstate its earning power. The government rushed out its reform to trump a lousy Tory

plan and then chopped and changed it. That has led some non-doms to conclude that Britain is no longer safe. The City is echoing with bankers prophesying an exodus: of shipping tycoons to Athens and private-equity partners to Geneva. It is impossible to know how many would really forsake London's schools, arts, restaurants, shops and—most of all—its financial expertise. If the City really depends on the slender non-dom status to survive, its days are probably numbered in any case. Yet some will leave. Liquidity is usually hard to shift, but 1960s New York taxed the bond market to London.

What to do? A wholesale reform of Britain's tax code would set up something fairer. Non-doms who settle in Britain need at some point to be treated like everyone else. Loopholes should be closed. But that is true for the whole of the tax system—indeed the treatment of non-doms may be less inequitable than, say, the varying treatment of depreciation or of married and unmarried couples. Reform by all means, but reform methodically and with a sense of what you will gain by it.

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Credit crunch

Plugging holes

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Central banks' latest moves to increase liquidity will ease but not solve the credit crunch

Illustration by Claudio Munoz

YOU might call it the sandbag approach to central banking. As the turmoil in credit markets deepens and broadens, central banks, particularly America's Fed, have devised ever more ways to bolster the markets against collapse by providing more funds to more actors, for longer periods and against broader ranges of collateral.

This week brought the latest round of sandbagging. In two announcements, on March 7th and 11th, the Fed promised a series of new measures. It expanded the facility through which banks can bid for liquidity and introduced a new scheme under which the central bank would provide up to $200 billion of Treasury bonds to market-makers in return for dodgier assets, such as mortgage-backed securities (see article). On March 11th, other central banks joined in too.

Financial markets were delighted. Wall Street's main share indices enjoyed the biggest one-day rise in over five years. But the optimism did not last. Within days dollar selling drove gold above $1,000 an ounce and the dollar below ¥100. Though the Fed's tools are useful, the bad news is not over.

The logic behind broader liquidity provision is simple: to break a vicious circle of fear and forced selling. In recent days, many corners of the credit markets were becoming dysfunctional, with investors refusing to hold all but the safest government bonds. Spreads in normally safe and liquid markets, such as bonds issued by the quasi-official mortgage giants, Fannie Mae and Freddie Mac, widened alarmingly and prices wobbled. Higher volatility and wider spreads prompt banks to demand more collateral from borrowers, which in turn exacerbates the mess (see article). By offering the safe Treasury bonds that investors crave, and holding unwanted securities in return, the Fed intends to block this spiral.

A modest risk

That makes a lot of sense. By reducing the panic-induced part of widening credit-spreads, the new liquidity tools mitigate the damage that dysfunctional credit markets would otherwise wreak on the economy. They also take the pressure off the central bank's other, rather blunter, policy tool—lower interest rates. The Fed has already slashed short-term interest rates by 1.25 percentage points in the past two months, in part to counter the credit turmoil. Before this week's liquidity actions, financial markets expected another three-quarter-point cut at the Fed's next rate-setting meeting on March 18th. With commodity prices soaring, the dollar plumbing new depths and expectations of future inflation on the rise, such a large rate-cut would be risky. The new liquidity tools reduce the odds that the Fed is spooked into recklessness.

Equally important, these gains come at only modest risk. The Fed will hold dodgier securities. But by taking them as collateral for temporary loans and at a discount, it would lose money only if there is a bankruptcy among the market-makers borrowing Treasury bonds. The ECB has long taken such securities as collateral. In the long term, central banks' willingness to broaden liquidity support during crises may induce banks to behave more riskily (a temptation that will need to be countered with more effective rules on banks' own liquidity). But that hardly seems a problem today.

The biggest danger is excessive expectations. Liquidity provision, however artful, is not a magic bullet for the credit crunch. It alleviates panic and buys time, but does not eliminate the underlying losses, get rid of the uncertainty about who holds them, or prevent the inevitable credit tightening that will follow.

And the bad news is far from finished. As foreclosures and falls in house prices accelerate, estimates of likely losses on mortgage-backed securities, now around $400 billion, are still rising. The credit contraction these losses will spawn has hardly started. Yet the economy is already in recession. That is not official, but the latest jobs figures, which showed private-sector employment falling in each of the past three months, leave little doubt that the economy is contracting. More mortgage losses will result as joblessness spawns foreclosures, along with higher defaults on everything from credit cards to corporate loans.

There are some bright spots. Banks are limiting the scale of the squeeze by raising new capital, over $100 billion so far—though they could raise more. The downturn is being cushioned by still-strong global growth (see article). George Bush's fiscal stimulus package will soon add a short boost. But, all told, recession suggests the credit problems will get worse before they get better. The Fed's sandbag strategy will help ward off disaster, but it won't shore up a sagging economy.

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Malaysia's election

The no-colour revolution

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Voters in Malaysia are at last no longer afraid to support the opposition

Reuters

THERE was no grandstanding on tanks; no sea of banner-waving protesters in monochrome T-shirts; not even a change in the federal government. Yet Malaysia underwent a quiet revolution on March 8th. The political scene transformed itself overnight. That the change happened at the ballot box and not in the street makes it all the more cheering.

For 50 years since independence, Malaysia has been ruled by a coalition dominated by the United Malays National Organisation, or UMNO. Malaysia has prospered wonderfully, and the arrangement seemed immutable. Not any more. The governing coalition, the National Front, won the election for the federal parliament and eight of the 13 state assemblies easily enough (see article). But in a huge swing it lost the two-thirds majority in Parliament that it has enjoyed for 40 years, and which enabled it to change the constitution at will. In peninsular Malaysia (ie, excluding Malaysian Borneo), it actually—if narrowly—lost the popular vote. In five states, including the most populous, the opposition will form the government.

This is extremely good news for many reasons. The most basic is that democracies need a vibrant and credible opposition. Any party that stays in power for half a century is liable to show signs of complacency, arrogance and corruption, and UMNO is no exception. Abdullah Badawi won by a landslide in 2004, partly because of a promise to clean things up. Voters have turned against him not least because he is seen as having failed, or—worse—as not having even tried hard.

Second, the election result is a victory for hope over fear. At times the government has used harsh laws against opponents. Anwar Ibrahim, the leader of what is now the largest opposition party, and Lim Guan Eng, the new chief minister of the state of Penang, have done time in jail. More generally, the National Front has played on the fears evoked by the ghosts of 1969, when opposition advances at the polls were followed by bloody race riots. A vote for the opposition, went the none-too-subtle message, would risk bloodshed as the Malay majority took its revenge on the minorities. Yet it was not only many ethnic-Chinese voters (about a quarter of the population) and, especially, disgruntled ethnic Indians (about 8%) who deserted the National Front. Many Malays switched too.

That is a third reason for optimism: communal tension may not be the tinderbox that Malaysia has for so long assumed it to be. If so, the result may herald new thinking about the institutionalised racism of the pro-Malay affirmative-action policies introduced after 1969. The opposition parties campaigned on a platform of “colour-blind” affirmative action—help for those who need it, not for a particular ethnic group. In the past, that would have been deemed electoral suicide. Surely Malays would not vote against their own economic self-interest? In the event many seem to have recognised that the policy has become less a means for redistributing wealth to the disadvantaged than a vehicle for corruption and cronyism.

And now revolve even more, please

Of course, the opposition still has a long way to go. It is a loose coalition of ill-matched parties: a left-of-centre, mainly ethnic-Chinese one; an Islamist party that in the one state it has ruled since 1990 has banned unisex barbers and introduced single-sex tills in supermarkets; and Mr Anwar's multi-ethnic liberal reformers. They may make a mess of governing the states they have won, or prove as venal as those they have replaced. They have co-operated well in opposition: the Islamist party has moderated its demands, so as not to scare off the Chinese and Indian supporters of the other parties, and they made good tactical choices about who should contest which seat. But by the time of the next election, they will need to win votes as a potential government, rather than as a symbol of protest.

Or perhaps by then UMNO and the National Front will have reformed themselves. The first signs were good. Mr Badawi accepted the setback with grace. Opposition leaders avoided gloating and told their supporters not to celebrate in the streets lest they provide an excuse for troublemakers. Such maturity and restraint may not last. But in a region where competitive politics are so often feared because they are associated with instability, they offer a beacon of hope.

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Spain's election

Zap back

Mar 13th 2008
From The Economist print edition

José Luis Rodríguez Zapatero's second term will be a lot more testing than his first

Reuters

NO LONGER is José Luis Rodríguez Zapatero the accidental prime minister. In March 2004, luck helped to bring the leader of Spain's Socialists to power: he was trailing in the polls until a cack-handed attempt by the ruling centre-right People's Party to blame the Madrid train bombings three days before the election on Basque separatists. This time he consistently led his PP rival, Mariano Rajoy, and duly won re-election on March 9th. Yet his second term promises to be far harder than his first.

For one thing, the Socialists again fell short of an absolute majority in parliament, so Mr Zapatero will need a regional party's backing (see article). His best bet is to dump the left-wing Catalan separatists in favour of their moderate rivals, Convergence and Union (CiU). The CiU may well demand still more autonomy for Catalonia, but it is broadly liberal on economic policy. This matters, for the economy will be Mr Zapatero's biggest headache.

Spain has been one of the European Union's biggest success stories. Thanks to the macroeconomic stability afforded by the euro, lavish EU subsidies, a property boom and a huge influx of immigrant workers, the economy has grown by some 4% a year. Over the past four years, Spain has created two-thirds of all new jobs in the euro area's biggest four countries. But the good times have come to an abrupt end. GDP growth has slowed sharply, unemployment has shot up, house prices are falling and inflation has risen. EU money is running out and immigration will follow the economy down. Consumer confidence is at a 13-year low.

Spain's vote was the first post-credit-crunch election in a big Western country. Economic woes did indeed cost Mr Zapatero some support. Yet he persuaded many voters that the slowdown was not really his fault; and that the sensible choice in such risky times was his reliable finance minister, Pedro Solbes. The PP failed to come up with a convincing cure for the ailing economy. Mr Solbes presides over a healthy budget surplus worth 2% of GDP, giving him plenty of room for tax cuts and a splurge of public spending on infrastructure.

Yet fiscal expansion will not be enough, for the end of the good times is exposing deeper weaknesses. Successive Spanish governments worked strenuously to get the country into the euro, then sat back, accepting the benefits in lower inflation and interest rates, but failing to promote the more competitive markets that the discipline of euro membership requires. Spanish labour laws are too restrictive. Rising costs are denting the competitiveness of manufacturing, which makes up a big chunk of the economy. Productivity is held back by poor education and training. Immigration and the property bubble made up for these failings for a while, but no longer.

In search of bipartisanship

Economic liberalisation is hard, as many other European governments have found, because reforms tend to be fiercely opposed by unions and other vested interests. That makes it desirable to seek bipartisan support for the more controversial ones, such as labour-law changes. In the past four years, Spanish politics has been characterised by a rancorous bitterness. But Mr Rajoy's concession speech was dignified, and Mr Zapatero wisely responded with a promise to work “without tension, without confrontation”.

Defusing Spain's regional tensions also demands a new bipartisanship. Here Mr Zapatero threw caution to the winds in his first term, drawing up a new statute for the Catalans and negotiating with ETA, the violent Basque separatist group, in the teeth of PP opposition. Yet the Catalans always seem to demand more concessions, and other regions tend to copy them. The talks with ETA failed (the terrorists seem to have been responsible for the killing of a retired Socialist councillor in the Basque country two days before the election). And Basque nationalists are threatening to go ahead with a referendum this autumn on their future status in Spain.

Unity among politicians helps solve big questions of national identity. Britain had to adopt a bipartisan approach to settle its Northern Ireland problem. Spain's experience suggests that it needs to do the same.

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On America's primary elections, Japan, Israel, Russia, Jersey, potatoes, the world

Mar 13th 2008
From The Economist print edition

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Election round-up

SIR – You unfortunately gave the wrong impression that Barack Obama may have been a Muslim in his youth when you said he "spent time at a Muslim school in Indonesia" ("Brand disloyalty", March 1st). While in Indonesia Mr Obama attended a Catholic school first, and then a state school, SDN Besuki. Indonesia is predominantly Muslim so state schools of course reflect the dominant religious culture. However, SDN Besuki is a widely respected public institution that does not focus on religion, but rather on the national curriculum. It also happens to be located quite close to the American ambassador's residence.

Robert Gelbard
Former American ambassador to Indonesia
Washington, DC

SIR – Many people have criticised the performance of opinion polls during this primary-election season ("Obama by one. No, ten. No, five", March 1st). Some polls do a better job than others. Whereas the record of polls in predicting general elections (especially presidential elections) has been pretty good, their record in primary elections has often been bad, and probably always will be. Polls predicting primary-election results get the outcome wrong because of low turnout, the near impossibility of determining accurately who will and will not vote, and the extreme volatility that sometimes occurs after interviews have been completed. Frankly, it is a mug's game.

Humphrey Taylor
Chairman
The Harris Poll
New York

SIR – I must object to your usage of the term "the Dunkin' Donuts crowd" to refer pejoratively to "people who earn less than $50,000 a year and lack a college education" ("The end draws nigh", February 23rd). A law student myself and a big fan of the goodies at Dunkin' Donuts, I have no plans to discontinue my patronage of the chain when my income increases. Moreover, this type of classist rhetoric is precisely not what American voters need from the media. Let's leave that to the political candidates.

Ames Grawert
New York

Japanese politics

SIR – Your briefing on Japan's economy hinted that the leadership of the Democratic Party of Japan was partly responsible for the country's economic stagnation ("Why Japan keeps failing", February 23rd). However, the DPJ has highlighted issues such as petrol taxes going to a special fund for road construction and exposed scandals at the Ministry of Defence. It is regrettable that you never touched on these.

Furthermore, I strenuously object to the title on the cover of your Asia edition, "Japain". Japan is the official name of our nation, registered and acknowledged by the United Nations and other international bodies. It is completely outrageous that you combined the word for our nation with "pain". You made fun of our respected nation's name on a cover that is sold on newsstands all over the region. This conduct is equal to burning a national flag, which is base and inconsiderate. No nation's name should be treated like

this.

Tetsundo Iwakuni
Director of the International Bureau
Democratic Party of Japan
Tokyo

Under fire

SIR – How comforting that the rockets raining down on the Israeli town of Sderot are “seldom lethal” or that the suicide-bombing in Dimona was “the first such attack for many months” (“Split by geography and by politics”, February 23rd). Any other nation under such outrageous attack would also respond with force. However, Israel must contend not only with bitter enemies, but with a media ever ready with its carping criticisms.

Richard Wilkins
Syracuse, New York

The talons tighten

SIR – Regarding your leader on Dmitry Medvedev's ascendancy to the Russian presidency (“Russia's uneasy handover”, March 1st). As Vladimir Putin seems intent on keeping his grip on Russian politics, Mr Medvedev will find he has to indulge in some serious power-sharing. One should note that the official insignia of imperial Russia and now of the Russian Federation is the double-headed eagle.

Arsenie Muntean
Shrewsbury, Shropshire

Jersey news

SIR – The final paragraph of your article on Jersey states that there were frequent arguments “over content” in the *Jersey Evening Post* with Frank Walker during the time he was chairman of the company that owned the newspaper (“Not seen, not heard”, March 1st). I would like to clarify that the arguments always occurred after the fact of publication. Mr Walker, who is now the island's chief minister, was in the habit of complaining bitterly if he thought he had been misrepresented in his political role in our columns. This, I am sure you will agree, is different from trying to influence content before publication.

Rob Shipley
Deputy editor
Jersey Evening Post
St Saviour, Jersey

Mashing spuds

SIR – You praise the potato, but forget its myriad detriments (“Spud we like”, March 1st). The potato may be a cheap source of calories, but its high glycemic index and its lacklustre nutrients (which are lessened by cooking) makes it an unhealthy food for today's ever-fattening population. And sure, the tuber is cheap to grow, but is it sustainable?

Its widespread cultivation is not good for the food security of many countries. Indigenous food crops are neglected while the potato is pushed as a calorific panacea. Less variety means less food security for subsistence farmers, as was clearly demonstrated in the Irish potato famine. It also means fewer foods to enjoy and a dulling of culinary life for much of the world. So while planting the potato was helpful for trade and industrialisation, it is now a detriment to the overall happiness and fitness of the human race.

Justin Hahn
Seoul

SIR – My ancestors left Ireland in the 1840s because the potato crop failed, but it kept them alive here and they prospered. Tonight I will have some French fries with my home-made burger and that great Canadian favourite, ketchup-flavoured potato chips. Tomorrow morning it will be bacon, eggs and, of course, home-fried potatoes.

Neil Alexander
Miramichi, Canada

The global picture

SIR – I refer to the cartoon accompanying Charlemagne's musings on globalisation (March 1st). The drawing shows the correct 23° tilt of Earth's rotation axis, but the edge of the shadow cast by the sun is incorrectly drawn along a meridian. The shadow should have been drawn vertically, otherwise we would be in perpetual equinox. Readers need a more realistic perspective on the world.

Dennis Engel
New York

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London and Paris

The rivals

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Photodisc

Two great cities are about to hold mayoral elections. Which has the brighter future?

WHEN running for president of France last year, Nicolas Sarkozy made an unusual campaign stop: London. Speaking in a converted fish market, before a rapt crowd of French expatriates, he called Britain's capital “one of the biggest French cities”. It had, he went on, the “vitality that Paris so badly needs”.

The French and British capitals are linked as never before. Since the opening of Britain's first high-speed rail link last November, arriving into beautifully restored St Pancras, only two-and-a-quarter hours separate the two. An estimated 200,000 French people now live in London, serving coffee or trading derivatives; waiting lists groan at the Lycée Français in South Kensington. The British population in Paris, far smaller, still numbers some 22,000.

The two cities fought fiercely to host the 2012 Olympic games, until—to Paris's consternation—London won. That victory still rankles on the banks of the Seine. Both capitals also happen to be run by left-wing mayors, the Socialist Party's Bertrand Delanoë in Paris and Labour's Ken Livingstone in London, whose mandates are about to expire. Voters in each city are heading to the mayoral polls in Paris on March 16th and in London on May 1st.

Londoners and Parisians alike will not simply cast their votes on local grounds. In Paris, voters are partly seizing the chance to snub Mr Sarkozy, whose poll ratings have slumped. Against a lacklustre rival on the right, Françoise de Panafieu, the popular Mr Delanoë looks likely to secure a second term, which would be a spectacular victory in a city considered for decades a stronghold of the Gaullist right. In London, voters could decide to send an electoral message to Gordon Brown, the British prime minister, and will be able to test the new-look Conservatives. The outspoken Mr Livingstone, whose team has been dogged by charges of cronyism, is challenged on the right by Boris Johnson, a mop-haired former journalist and Conservative MP, and in the centre by Brian Paddick, a Liberal Democrat and former police chief.

The jobs at stake are not exactly the same. The Paris mayor does not govern the *banlieues*, and runs a city numbering just 2.3m people (fewer than the 2.9m in inner London). His London counterpart is in charge of fully 7.4m people, more comparable to the 6.4m who live in Paris and the three departments encircling it combined. The Paris mayor, however, has broader powers: while both cities' mayors are responsible for planning and transport, the Paris town hall also runs social housing and primary schools, for example. This gives Paris's mayor a relatively bigger budget: €7.6 billion next to London's €14 billion (£10.7 billion).

All the same, candidates of every stripe in both Paris and London are campaigning on remarkably similar promises: to make housing affordable, to lower CO_2 emissions, to discourage the use of cars, to green the city; and to burnish the image they want to project to the rest of the world. For Paris and London these days are also fierce competitors: for investment, besides the more intangible qualities of inventiveness and style that make a “world city” in the global mind.

From the balcony on the top floor of the London mayor's lopsided plate-glass office on the south bank of the Thames, the din is deafening. Nine floors below, diggers and drills are ripping into the earth and cement-mixers are churning. The most arresting feature of the London skyline these days is not the new architectural landmarks—the Gherkin, Tate Modern, City Hall—but the staggering number of cranes. In the centre of Paris, there are none.

By most economic tests, London outstrips Paris. Its stock exchange, by market capitalisation, is two-and-a-half times larger. It is the world's biggest market for global foreign exchange, over-the-counter derivatives and international bonds. As a destination for the funds of foreign investors, it is consistently rated the top city in Europe in annual surveys by Cushman & Wakefield, a property-services firm. Between 2002 and 2006, London grabbed 24% of foreign direct investment in Europe's 15 biggest cities, compared with 19% across the Greater Paris region, according to a study by Ernst & Young, an accounting firm. Londoners are also better off than those living in Greater Paris: even when adjusted for purchasing power, they are on average 8% richer per head.

In haute cuisine, as in haute couture, Paris may still triumph. It boasts, for instance, nine three-star Michelin restaurants; London has one. But the French capital has been slower to embrace the more informal gastronomic culture, where a three-tier cheese trolley is not necessarily a badge of excellence. Over the past few years, London has spawned a giddy mix of new restaurants and bars, as well as internet start-ups, design studios and art galleries. Inner London's growing population, boosted by immigration, is set to swell by at least 17% by 2026. While its suburbs keep growing, the population of Paris, by contrast, is expected to drop by 3% by 2030 according to INSEE, the official statistics body. French publications feature such titles as “Paris is falling asleep” and “Is Paris dying?”

Indeed, officials at London's City Hall bristle at the idea that the two cities can be compared. “We don't think of ourselves as in competition with Paris,” sniffs John Ross, Mr Livingstone's economic adviser. “We've won that contest. We measure ourselves against New York.”

Managing chaos

Yet as recently as 1992, when the Maastricht treaty to launch the euro was signed, bankers in London were fretting about losing out to the financial centres within the future euro zone, notably Paris and Frankfurt. Back then, the pre-eminence of the British capital was far from assured. At the time, Jack Lang was the cool, polo-necked French Socialist culture minister, rejuvenating Paris with glass and steel, while his British equivalent was in charge of something stuffily called the “Department for National Heritage”. London's streets were gridlocked, its riverside was drab, its food inedible and coffee undrinkable. What went right for the city?

A number of things. First, Big Bang, the deregulation of the financial-services sector in 1986, propelled foreign investment into the City of London (though the markets were rocky in some subsequent years). The Labour government elected in 1997 kept the city attractive with stable economic management and with corporate and income taxes that were low, at least by French standards—though these are set to rise for non-domiciled residents. And it cared about the image of the capital, too. The Labour government not only spent freely on the arts, but also abandoned its resistance to using private sponsorship to build new galleries and museums. In doing so, it helped to shrug off a British indifference towards the look of London. Daring modern architecture proclaimed that this was a true world city.

Perhaps most important, the city has adopted a guiding creed that belongs neither to the political left nor the right: openness to change. “London has flourished not because it has sorted out its transport, or its city management, but because it opened its borders,” argues Tony Travers, director of the Greater London Group at the London School of Economics. These days, there is nothing particularly British about London, bar its tolerance of chaos. It has embraced globalisation to become an international city, while Paris has remained unapologetically French.

Nearly 700,000 extra foreign-born people have made London their home since 1997, bringing the capital's total foreign-born population to over 30%. Not counting illegals, Paris has fewer foreigners (about 14%) and, crucially, it is the more educated ones, whether from India or Poland, who head for London. (In total, Britain has attracted more skilled and professional immigrants: 35% of them have a college education, according to a recent OECD study, against just 18% in France.) The energetic renovation of newly fashionable districts such as Hoxton and Shoreditch is not only spurred by sky-high property prices elsewhere; it also owes something to the friction and renewal of London's messy, cosmopolitan mix. “Creative types don't want bourgeois homogeneity,” says Mr Travers. “They want edginess, and space to grow.”

The bragging list

	London	Paris
Population under mayor's remit, m	7.4	2.3
Prime office rent, € per sq m per year	2,277	1,035
Number of top ten world football clubs by revenue, 2006-07	2	0
Number of 3-starred restaurants, 2008	1	9
Average speed of traffic in central city, kmph	12.9	15.9
Price of single zone 1-2 metro ticket, €	peak: 8.24 peak: 6.28	1.50 1.50
Number of world's top 20 tourist attractions	1	5

Sources: National statistical offices; Thomson Datastream; Cushman & Wakefield; Deloitte; Michelin; Transport for London; Forbes Traveller

The Sleeping Beauty

Until recently, two vast competing public renovation projects in Paris stared squarely at each other across the Avenue Winston Churchill, in the capital's smart 8th *arrondissement*. On one side, workers were busy restoring the 14,900-square-metre glass-domed roof of the Grand Palais, built for the Universal Exhibition in 1900. Opposite, restorers were at work on the scaffolding-clad Petit Palais. Each project was wrapped in a large billboard. “The state is restoring the Grand Palais,” read the first; “The Paris town hall is restoring the Petit Palais,” retorted the second. In their proud and rival aspirations to maintain the city's cultural heritage, these two signs seemed to make a firm statement: that historic Paris is worth investing in, and that the public purse is the way to do it.

Arguably, if London these days is marked by innovation, Paris favours preservation. While London seems to be stressing its desire for change with its new—and often controversial—architectural projects, the City of Light appears more concerned with scrubbing up what it already has. And to stunning effect: the buildings, boulevards and bridges of central Paris gleam. Fleets of cleaning vehicles brush and rinse its surfaces, day and night; floodlit monuments light up a magical night sky.

Yet this fondness for its intrinsic elegance seems to have bred a form of conservatism. “In terms of urban planning, Paris has been half-asleep,” says Thierry Jacquillat, head of Paris-Île-de-France Capitale Economique, a lobbying group. “Through its avant-garde architecture, London has an image of dynamism that does not exist in Paris.”

To some of its residents, this is a relief. Apart from La Défense, the business district to the west of Paris, which is due to get a new series of designer skyscrapers in the coming years, the capital has always resisted, for instance, the construction of high towers—much to the frustration of Mr Delanoë, who would like to plant some on the periphery. Indeed, an extraordinary collection of early colour photographs from 1907 onwards, currently on display at the Paris town hall, is a reminder of just how little the city—from its Art Nouveau metro signs to its corner café-bars—has changed physically since then.

In part, this conservatism fits a French tradition. A strong state has long attempted to defend the French way of life. All the capital's tiny *boulangeries*, selling freshly baked baguettes in twists or knots, or *papeteries* with their watermarked writing paper in ribbon-wrapped leather boxes, are kept in business partly by custom and taste. But they are also deliberately propped up by a tightly regulated retail industry, under which hypermarkets are not allowed to sell below cost. Successive governments, too—including the current one—have caved in to the militant taxi lobby, and have not dared to increase the number of licences. This keeps the taxi drivers quiet, but makes it almost impossible to hail a cab on the street.

To be sure, it is easier to innovate when there is less to preserve. London's restaurant pioneers had no gastronomic tradition to uphold. London can afford to be bold with its architecture, since its riverside skyline has none of the unbroken elegance of that of Paris. When the French capital has in the past been audacious, as when François Mitterrand commissioned I.M. Pei to build a glass pyramid in the courtyard of the Louvre, it prompted a local outcry. Many of the subsequent *grands projets*—the Grande Arche at La Défense, or the National Library of France—were pushed out to more peripheral sites.

Nor is it fair to say that Paris has stayed still. “Paris as a museum city is a caricature,” retorts Mr Delanoë. “The city needs to respect its heritage, but also add to it for the future.” He points to Paris Rive Gauche, a modernist redevelopment on the left bank in eastern Paris, complete with a looping pedestrian “Simone de Beauvoir” bridge across the Seine. His Vélib rent-a-bikes, available at 1,450 street corners across the capital, have been a huge hit. Along with a new tramway, widened bus routes and pedestrianised weekend *quai*-side roads, Mr Delanoë's Paris in many ways captured the ecological mood before it became fashionable.

All the same, as Mr Sarkozy has lamented, Paris seems to lack London's dynamism. Marc Levy, a French novelist who has chosen to make London his home, argues that the conservative attitude towards planning and architecture has a direct effect on creative life. “Paris doesn't take risks, it lacks audacity,” he says. “How can you create a desire to innovate when the ambient culture is oriented towards preservation?”

The price of audacity

London's more chaotic, laissez-faire approach, however, has its downside. It has become a city of excess, in all senses. Its economy is more reliant than Paris's on financial services, a sector prone to global swings such as the current credit crunch. This makes London's property market more volatile, too. Commercial office rents in London's West End are currently the most expensive in the world, according to Cushman & Wakefield: more than twice as much per square metre as those in Paris. Both London and Paris have been favourite destinations for investors in European commercial property, but this year faster-growing Moscow and Istanbul are supplanting them, according to a new study by the Urban Land Institute and PricewaterhouseCoopers. London may breed more start-ups, but also plenty of fold-downs; almost as many restaurants seem to close their doors as open each year.

For residents, too, London has become a victim of its own success. When rents and food prices are taken into account, it is the world's most expensive city, according to a study by UBS: beating New York and way ahead of Paris, in 11th place. High property values price first-time buyers out of the market, besides crowding out other topics of dinner-table conversation. Londoners are more worried now about housing costs than anything else, according to a recent survey by the mayor's office.

London has also consistently failed to plan for its expansion. The creation of the post of mayor in 2000, and Mr Livingstone's election to the job, helped temporarily to ease jams on the roads thanks to a congestion charge and a big investment in buses. The improvements, however, have been short-lived. The Underground's modernisation project has been a shambles, its financing a fiasco. After decades of wrangling, there is agreement at last on a fast underground Crossrail linking suburbs west and east, but this will not be open until 2017 at the earliest and the cost has spiralled. (By contrast, Paris has for years enjoyed a network of five RER rapid cross-city underground lines.) Heathrow airport is a torture-chamber, and the opening of its new Terminal 5 is unlikely to make much difference.

London's public hospitals, doctors' surgeries and state schools are creaking; its private alternatives are reserved for the rich. The capital as a whole may be thriving, but it still has its share of poverty, underlined by a wave of stabbings and shootings of teenagers in poor areas. Indeed, Mr Livingstone argues that the chief reason he wanted to host the Olympic games was not because of the sport, but in order to secure central-government money for the regeneration of the city's run-down eastern fringes.

Yet Paris, for all its interventionism, has not managed to shelter its own people from poverty. Over the past ten years, rental costs have shot up. Many middle-class families have fled to the cheaper suburbs, leaving an increasingly polarised population in the centre: the rich in the *beaux quartiers*, and the heavily African poor in the north-eastern neighbourhoods. Students may still occasionally riot at the Sorbonne, but none of them can afford to live near it these days. Above all, Paris is cut off administratively from its heavily Muslim *banlieues*, the scene of three weeks of rioting in 2005. There, on some housing estates, unemployment touches 50%, over five times the national average. Mr Delanoë's remit stops at the ring-road, the *périphérique*. Beyond it, each suburb is governed by its own mayor: a staggering 1,281 of them across the Île-de-France.

Swallowing the suburbs

The administrative split carries an unhelpful symbolism. “We're from 9-3,” is an often-heard refrain on the housing estates of Seine-Saint-Denis, the northern *banlieue* with that postcode, “not from Paris.” The fragmented power structure also holds up decision-making, not least in endless political wrangling between left and right. François Pinault, a business magnate, got so frustrated by political bickering when he tried to build a modern-art museum on the outskirts of Paris that he took his collection to Venice instead.

Politicians are beginning to come round to the idea of a unified city-plus-suburbs structure for Paris. Once this month's elections are over, Mr Sarkozy, on the centre-right, says he wants to create a “Greater Paris”. Mr Delanoë, on the left, talks too of a “Paris Metropole”. Whether they can get over their political differences remains to be seen. As it is, the right accuses the left of wanting to annex the suburbs; those in posh districts, like Neuilly, fear that the city just wants to grab their tax revenues. But the creation of a Greater Paris could well turn out to be a way both to get Paris to reach out to its *banlieues*, and to give the city a more innovative look outside its historic districts.

As for London, with bonuses, profits and jobs now on the line in the City, the ambience is more morose than it has been for years. Yet the city of excess has been through slumps before, and bounced back. In many ways, its bigger challenge is to cater to those who do not benefit from boomtime, and to manage the inequalities that the city has always bred. One test of this will be how it uses the Olympics, regarded coolly by many of the city's richer western residents, to revive eastern districts for their locals. Sprawling, crowded, hectic, serendipitous: like it or not, London as a whole seems to be kept going by a form of raw energy. And after all, to misquote Samuel Johnson, “When a man is tired of London, he can always go and have a three-star meal in Paris.”

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Exports and the economy

A few good machines

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Exports are cushioning America's downturn. But for how long?

Eyevine

AMID the ageing brick warehouses of South Boston, an assembler at the Cole Hersee switch plant inserts the pin into a roller connecter, flattening each end with a metal press to keep it secure. With the economy in a funk, you might expect such an old-style manufacturing firm to be struggling. But many of the company's switches are destined to regulate the power flow on the rigs that Caterpillar, an Illinois-based heavy-equipment manufacturer, exports in skyrocketing volumes to Asia and Latin America.

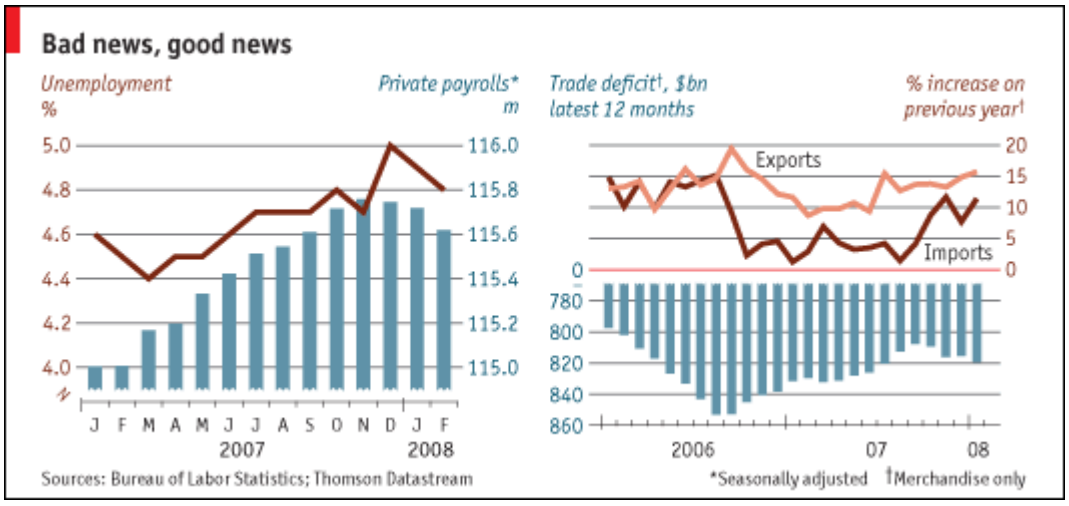
According to Don Mayer, Cole Hersee's vice-president, the company's revenue grew a tad last year. Domestic demand for many of its wares slowed, but sales to Caterpillar rose smartly. That, writ large, is the story of America's economy. The housing bust, the credit crunch and a weakening labour market have dragged down domestic spending. The economy has probably slipped into recession—but exports are easing the pain.

America's housing crash continues to worsen. The pace of home building has plunged and is likely to go on doing so. And the latest statistics suggest commercial construction has also started to fall. House prices have dropped by some 10% from their peak and the pace of decline is accelerating. With many sources of mortgage finance evaporating and many unsold homes, prices have much further to fall. Foreclosures and mortgage delinquency rates are already at record levels—some 6% of borrowers, nationwide, are behind on their payments. Homeowners' debt now exceeds their equity for the first time since the Fed has gathered the data. Around 9m homeowners have “negative equity”, mortgage debts greater than the market value of their homes.

Not surprisingly, estimates of the likely losses from mortgage defaults are rising. Worries about the scale of these losses, and uncertainty about who holds them, keep roiling financial markets. In early March spreads began to widen alarmingly on all manner of debt. To stem panic, the Federal Reserve on March 7th and again on March 11th announced new schemes to boost liquidity (see article). Stockmarkets cheered, but the impact is likely to be limited. As the mortgage-related losses mount, credit conditions will tighten, adding to consumers' woes.

The labour market, too, is weakening. The economy unexpectedly shed 63,000 jobs last month, the largest decline in five years. Exclude government-related jobs and the fall was 101,000. Hardest hit were construction and manufacturing, the former a direct casualty of the housing mess, the latter a victim of falling domestic demand, particularly for cars. Employment in retailing also shrank, indicating that the pain is spreading more broadly. Unemployment is still low. The jobless rate fell only slightly, to 4.8%, yet this is more a sign of weakness than strength as the number of Americans looking for work plunged.

But amid the gloom, one bright spot remains: America's export sector. Exports increased twice as fast as imports in 2007, narrowing the trade deficit for the first time since 1995. In recent years, the widening trade deficit has dragged down America's output growth. Now trade is keeping the economy afloat. In the last three months of 2007 the combination of growing exports and shrinking imports added nearly a percentage point to the annual rate of GDP growth, while the economy overall grew by only 0.6%.



Thanks to high oil prices, America's trade deficit widened in January (see chart), but if oil is excluded, the deficit is shrinking fast. Imports are slowing as consumers and firms cut back, while the combination of a weak dollar and still-strong global growth means exports of goods and services are rising smartly. Cheaper labour costs are also encouraging foreign direct investment, which was up a quarter in 2007.

The primary beneficiaries have been commodity producers, the hospitality industry and certain types of manufacturers. Farm incomes are increasing rapidly. Mining is booming. Visits from overseas were up 10% in 2007 (see article). Foreign demand for advanced machinery is huge; exports of civilian aircraft, drilling tools, telecommunications equipment, agricultural machinery and excavators all rose at double-digit rates in 2007. Caterpillar's North American machinery sales were down 11% last year, but its business with Latin America increased by 24% and with the Asia-Pacific region 31%. The company is predicting bumper growth again in 2008. In some industries the shift has been dramatic. Exports of iron and steel products rose 21% in 2007, while imports fell 17%.

Resources are shifting into these industries, helping to cushion the downturn and reorient America's economy. While employment in construction is plunging, export-related manufacturing and mining employment is at its highest level in a decade. Though American manufacturing is losing 50,000 jobs a month, past downturns have typically seen lay-offs at twice that rate. For all that, the effect on jobs will be limited. Mark Zandi, chief economist at Moody's Economy.com, points out that export-related manufacturing, in particular, is highly productive and therefore less prone to mass hiring. Export-related manufacturing and mining account for some 8% of GDP but only 1.5% of American employment. The weak dollar has rendered American labour more competitive, but not enough to rejuvenate low-margin, labour-intensive manufacturing in industries such as textiles, furniture or paper products.

The big question is whether exports can remain buoyant even as the rest of the economy slides into recession. Much depends on how far an American downturn—and the global fall-out from the mortgage bust—weakens growth in the rest of the world. Some slowing is inevitable, particularly in other rich economies, destination for around half of America's exports. But many emerging economies are more resilient than in previous American recessions. In earlier global downturns, American consumers saved the global economy. Now it may be the other way around.

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Tourism

Bargain-hunting

Mar 13th 2008 | BIG SKY, MONTANA
From The Economist print edition

The weak dollar lures visitors

AS THE Ramcharger chairlift cranks its frozen passengers to the top of Montana's Andesite Mountain, Jan and Lorene Nobert from Quebec beam about their American holiday. The snow this season, they say, is just as good as they'd heard it was. South Florida, meanwhile, is relying on its warm weather to attract foreign visitors. Fort Lauderdale recently sent over its “beachmobile”—a lorry bearing a heated, glass-enclosed fake seashore complete with palm tree, lifeguard tower and sunbathing models—to lure Britons tired of dull weather.

Non-Americans have a better incentive than winter gloom or Rocky Mountain peaks to visit America these days. The weak dollar makes even resort prices cheaper, not to mention the goods in the country's malls. The result is a healthy tourism industry, and a much-needed economic boost for some of America's worst-off regions. But is the tourist bump as big as it could be?

The Commerce Department announced this week that America ran a $17.8 billion travel surplus in 2007, more than double the 2006 figure. Arrivals from Canada were up 11%; from Mexico, up 13%. Visits from many west European countries, China and India also increased by double digits. Although its trade in goods runs a hefty deficit with the rest of the world, America boasts a widening trade surplus in services, which make up 30% of all exports. Travel and tourism now account for 8% of all exports, more than the auto business.

The weak dollar and high oil prices also encourage Americans to take their holidays nearer home, providing a further boost for domestic tourism. Nearly every state showed gains in leisure and hospitality employment in 2007, even places battered by the housing bust such as Arizona, California and Florida. As the country slides into recession, the tourist trade will be a vital counterbalance.

The biggest winners, of course, are huge tourist markets such as Miami or New York, which registered a 22% rise in overseas visitors last year. Retailers in these areas have boomed as Europeans stock up with dollar-denominated iPods, clothes and shoes, and hotels have seen revenues increase. But America's national parks are also seeing more visitors after slumping earlier in the decade, which enriches more remote spots.

Despite the bumper year, overseas tourism has not passed the peak it reached before the 2001 terrorist attacks. The industry wants the government to step up promotion abroad. Simplifying immigration procedures at America's borders might help a lot more, though.

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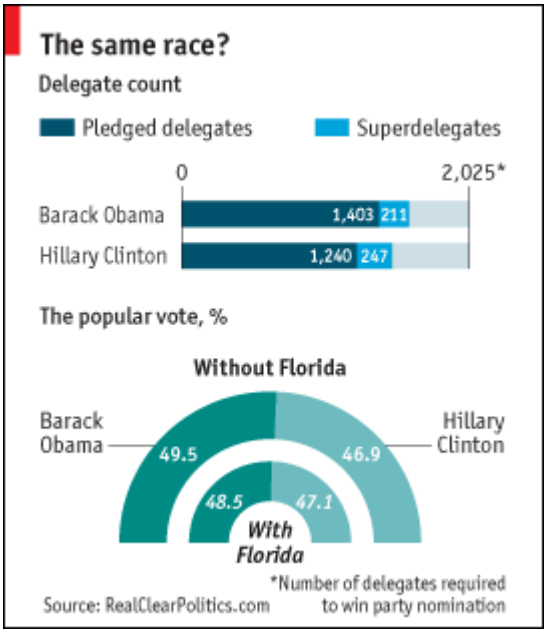
The Democrats

Getting fratricidal

Mar 13th 2008 | JACKSON, MISSISSIPPI
From The Economist print edition

Wins in Wyoming and Mississippi lift Barack Obama, but the race gets nastier



J.T. MANCE remembers what it used to be like for blacks in Mississippi. If you wanted to vote, you had to pass a “literacy test”, by satisfying a white poll official that you understood obscure bits of the state constitution. Whites were typically excused. Small wonder that Mr Mance, a retired construction worker, is excited about Barack Obama. As a Christian, he says, he'd like 10,000 tongues to praise the Lord. Likewise, “if I had 10,000 votes, every one would go for Obama.”

Mr Obama thrashed Hillary Clinton in Mississippi's Democratic primary on March 11th, by 61% to 37%. Three days earlier, he won the caucuses in Wyoming. Once again, he has momentum, which he briefly lost last week in Texas and Ohio. He has more delegates than Mrs Clinton (1,614 to 1,487, with 2,025 needed to win), and more of the popular vote. It will be hard for her to catch him.

Mrs Clinton is not giving up, of course. Her fans discount her loss in Mississippi because half the voters in the Democratic primary were black. Geraldine Ferraro, a former Democratic vice-presidential nominee and vocal Clintonite, told the *Daily Breeze*, a Californian paper, that “if Obama was a white man, he would not be in this position.” Mr Obama and his supporters say they are outraged. Ms Ferraro has had to resign as a fund-raiser.

If Ms Ferraro meant that Mr Obama's only appeal is his skin colour, her remark would clearly be absurd: Mr Obama has run a far sharper campaign than Mrs Clinton has, is an intelligent man and a fine orator, and has been less prone to engage in divisive talk. But if she meant that, in a close contest, his blackness is enough of a net plus to account for his lead over Mrs Clinton, it might be true. African-Americans adore him. And though some whites will never vote for a black, probably many more are eager to do so, if the candidate in question looks up to the job—especially if he campaigns in as admirably post-racial a manner as Mr Obama has done.

In Mississippi, Mr Obama's race mattered a lot. Nine blacks in ten voted for him. Some 40% of voters told pollsters that race was a factor in their decision, and 90% of these voted for Mr Obama. This is hardly surprising. Even late last year, many blacks took it for granted that no black could win the presidency. Mr Obama has convinced them they were wrong.

Accompanying two Obama volunteers knocking on doors in a black area of Jackson, Mississippi's capital, your correspondent found widespread elation and not a single Clinton supporter. Old ladies in bathrobes knew exactly where Mr Obama would be speaking that night. The volunteers themselves kept repeating how thrilled they were to take part in something historic.

Race cuts both ways, of course. Mrs Clinton won most of the white vote in Mississippi, as she has in most other southern states. But Mr Obama has won a majority of white votes in states as various as Virginia, New Mexico, Wisconsin, Illinois, Utah and, most recently, 90%-white Wyoming, proving that his appeal is increasingly cross-racial. Strikingly, his speeches to black audiences are little different from his speeches to white ones.

The next race, on April 22nd, will be Pennsylvania. Mrs Clinton hopes to do better in a state that abuts New York and is full of struggling working-class whites. Her strategy is twofold: to harp on about how

inexperienced Mr Obama is, and to hope that Democratic superdelegates, who will decide the nomination, will agree with her.

Mrs Clinton boasts that, as first lady, she helped to bring peace to Northern Ireland, to negotiate open borders to let refugees flee Kosovo, and that she urged military intervention to stop the genocide in Rwanda. Mr Obama's supporters gasp at her exaggerations. The *Daily Kos*, a left-wing blog, likened them to saying Yoko Ono was a Beatle.

Mrs Clinton is also lobbying to have the results in Florida and Michigan count: the two states' primaries were disqualified by the national party because they were held too early. Some Democrats say the rule should retroactively be changed. Others say this would be cheating, and argue for a fresh vote in both states. That would be tricky, however, given the lack of available time and money.

Simply letting Florida and Michigan count would help Mrs Clinton a lot, since she won both. But since neither she nor Mr Obama campaigned in either state, and Mr Obama's name was not even on the ballot in Michigan, that is hardly fair. Anti-Hillary feelings are already boiling. At rallies, Mr Obama's fans boo every mention of her name. Mr Obama shushes them, and then damns her with very faint praise, such as that she “would be a huge improvement on George Bush.”

Mr Obama is hoping that his supporters' passion will buoy him to the nomination and beyond. Certainly, it helps. But however many votes people like Mr Mance want to cast for their hero, come November, they only get one.

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On the campaign trail

Primary colour

Mar 13th 2008
From The Economist print edition

Backroom boy

“If we have to sit the two candidates down together...and try to figure out how to make peace and have a convention that's going to work, then that's fine. That's my job, and we'll be happy to do it.”

Howard Dean will be happy to decide the nomination in Denver. “This Week with George Stephanopoulos”, March 9th

It's all very technical

“There are elected delegates, caucus delegates and superdelegates...all equal in their ability to cast their vote for whomever they choose. Even elected and caucus delegates are not required to stay with whomever they are pledged to.”

Hillary Clinton suggests that Barack Obama's delegates could vote for her. Newsweek.com, March 8th

May I have some more?

“We can see the great job that our opponents have done in fund-raising. We've got a lot of work to do.”

John McCain has a lot of fund-raising ahead of him. Mr Obama raised $55m in February. Associated Press, March 9th

Loser take all

“I know that she has always been open to it, because she believes that if you can unite the energy and the new people that he's brought in and the people in these vast swathes of small-town and rural America that she's carried overwhelmingly, if you had those two things together she thinks it'd be hard to beat.”

Bill Clinton suggesting that Mr Obama should become his wife's running-mate. CNN.com, March 8th

Winner take all

“I don't know how somebody who is in second place is offering the vice-presidency to the person who is first place.”

Mr Obama responds. AP, March 10th

With the benefit of hindsight

AP

“I'd tell him to be careful about who he names to be the head of the selection committee.”

President Bush advises Mr McCain on choosing a vice-presidential candidate. Press conference, March 5th

Résumé rules

“I don't know there was much she did apart from accompanying Bill

going around...I don't want to rain on the thing for her but being a cheerleader for something is slightly different from being a principal player."

David Trimble on Mrs Clinton's claims to have brought peace to Northern Ireland. Daily Telegraph*, March 8th*

Trimble and cheerleader

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Health care

No relief on the right

Mar 13th 2008 | NEW YORK
From The Economist print edition

John McCain's health proposals are bad news for Big Pharma

“THE happy old days of the Republican establishment in DC protecting you from cost attacks are over.” That stern warning was given recently to a gathering of bosses from the health-insurance industry. Since it came from a senior strategist in John McCain's previous bid for the presidency in 2000, the words carried extra weight. Michael Murphy added, lest anyone in the room had missed his point, that Mr McCain “is more than happy to make a deal and grind down on that stuff.”

With bitter memories of the Hillarycare debacle, Big Pharma and the insurance industry certainly do not want Hillary Clinton as president. And despite all the noisy wrangling between her and Barack Obama over whether to oblige individuals to buy health insurance, the Democratic contenders have pretty similar reform proposals. Both would use the power of government to rein in drug prices and health-insurance costs. The surprise is that the industry no longer has a reliable Republican alternative.

Like his Democratic rivals, Mr McCain supports the import of drugs from Canada, which industry lobbies denounce as a violation of intellectual-property rights. Like them, he wants Medicare, the big government health scheme for the elderly, to negotiate bulk discounts with the industry—something Republicans have strongly opposed in the past. And he supports efforts to encourage “biosimilars”, a form of generic rival to biotech drugs, which the industry hates.

These and similar measures endorsed by Mr McCain in the Senate place him closer to the Democratic contenders on health policy than to any of his old rivals for the Republican nomination. However, that is not to say Mr McCain's proposals are exactly the same as those of his rivals on the Democratic side. They differ in at least two important respects.

First, rather than forcing an expansion of insurance coverage through government mandates, he hopes to motivate individuals to buy insurance through tax credits. Under his scheme, families would receive $5,000 to defray the cost of their health insurance. Mr McCain proposes to pay for this by scrapping part of the current tax break offered for employer-provided health schemes.

Second, he has some good ideas for tackling America's runaway health costs. Those are largely driven up by the overuse of technology and needless medical diagnostic tests and treatments. Mr McCain wants to reverse the perverse incentives that lead to such abuse by scrapping payments for individual procedures in favour of giving fixed payments to doctors and hospitals for actually solving particular health problems.

He also proposes tort reform that would impose caps on damages for malpractice and rule out awards for punitive damages: surely a sound proposal, since it would curb the “defensive medicine” that leads doctors to order needless tests and scans in order to protect themselves against any possible claim for negligence. But, however laudable, this last proposal is sure to send the Straight Talk Express head-on towards a lobbying group even fiercer than Big Pharma: America's tort lawyers.

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Illinois Democrats

Striking at the red heart

Mar 13th 2008 | CHICAGO
From The Economist print edition

A bastion of Republican strength elects a Democrat

THE roots of Illinois's sprawling 14th congressional district are deepest red. Stretching from suburban Chicago almost as far as the Iowa border, the district is home to Dennis Hastert, the longest-serving House speaker in Republican history, and contains the closest thing to a Republican Nazareth, Ronald Reagan's boyhood town. With its cornfields and subdivisions, mega-malls and mega-churches, the district has long represented the Republicans' strength in middle America. Well, it did until last week.

Mr Hastert resigned from Congress last year. On March 8th Bill Foster, a Democrat, beat Jim Oberweis in a special election to replace him—and he won easily, 53% to 47%. The National Republican Congressional Committee had poured more than $1m into Mr Oberweis's campaign, while Democrats spent almost as much on Mr Foster. The Democrats declared that the win had sent “a political shock wave across America”.

Republicans grumble that one special election does not make a national trend. Besides, Mr Foster will have to run again in November, as the special election gives him the post only until the end of the year. But his victory should indeed worry conservatives.

Mr Foster seems like a nice man, but he was not a notably charismatic candidate. It was his Democratic message—he wants to leave Iraq and supports universal health care—that seemed to resonate. A main selling point was an advert featuring Barack Obama, the Illinois senator and presidential hopeful. To be sure, Mr Oberweis was a lacklustre opponent. This was his fourth unsuccessful campaign. But it may be telling that Mr Obama's support seemed to buoy Mr Foster, while endorsements for Mr Oberweis by both Mr Hastert and John McCain, the Republican presidential nominee, failed to have much effect.

Mr Foster's coup also points to a demographic shift in suburbia, a change that may help Democrats in November and beyond. Illinois's suburban counties are growing rapidly—Kendall was America's third-fastest-growing county in 2006. This has brought new diversity. Chicago's suburbs are now home to more Latinos than the city itself. Booming suburban job centres have also attracted younger, more Democratic voters. In the primary on February 5th, conservative DuPage county saw Democratic ballots outnumber Republican ones for the first time in memory. This was due in part to Mr Obama's local celebrity, but it was remarkable nonetheless. “The easiest way to win an election is to change the electorate,” reckons Dick Simpson, a professor at the University of Illinois in Chicago.

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Water rows in the South

Take them to the river

Mar 13th 2008
From The Economist print edition

Georgia opens a northern front in its battle with drought

SOON after James Camak demarcated the border between Georgia and Tennessee in 1818, he began to develop doubts about his work. Thanks to a faulty sextant and bad astronomical charts, he had drawn the line a mile south of the intended boundary, the 35th parallel. Were the error to be corrected, Georgia would find itself in possession of a short stretch of the Tennessee river.

Until recently, Georgia's politicians did not pursue their claims to this sliver of territory very vigorously. But a bad drought, and the growing militancy of two other neighbouring states about the sharing of water, have prompted a change of heart. Last month Georgia's state assembly passed a resolution calling on the governor to set up a commission to look into the disputed boundary.

The mayor of Chattanooga, Tennessee, who would lose half his city if Georgia's claim were upheld, sent a consignment of bottled water to Georgia's lawmakers, saying it was better “to offer a cool, wet kiss of friendship rather than face a hot, angry legislator gone mad with thirst.” A wag among the recipients said they were accepting the water “as a down-payment”. In theory, the dispute could go all the way to the Supreme Court, although Georgia's chances of success would be slim: the court tends to award disputed territory to the state that has controlled it longest.

Most observers see the land-grab as an expression of desperation on Georgia's part. The state and especially its capital, Atlanta, are growing very fast. Atlanta's water supply relies on two rivers that have their source in Georgia before flowing into the neighbouring states of Florida and Alabama. For the past 18 years the management of the two rivers, called the Apalachicola-Chattahoochee-Flint (ACF) and the Alabama-Coosa-Tallapoosa (ACT), has been the subject of a series of lawsuits among the three states and the Army Corps of Engineers, which runs several reservoirs in the two basins.

Among other uses, Georgia wants more water for the showers and sprinklers of Atlanta, Florida for oyster farms at the mouth of the Apalachicola and Alabama for a nuclear power plant that draws its cooling water from the ACT. To further complicate matters, the Endangered Species Act requires the Corps to release enough water to maintain dwindling populations of rare mussels and sturgeon in the lower reaches of the two rivers.

The governors of the three states abandoned their latest attempt to agree on a formula for sharing the water last month, leaving matters in the Corps's hands. But they have not given up their lawsuits. In a victory for Florida, an appeals court recently threw out the Corps's decision to allocate more water to

Atlanta from Lake Lanier, the biggest reservoir on the ACF.

Atlanta has adopted vigorous water-saving measures. For almost all residents, tariffs rise sharply with consumption, which is unusual in America. Local utilities offer rebates to customers who install frugal lavatories. Nonetheless, says Pat Stevens of the regional planning authority, the city will not be able to cope without the water the Corps had promised it. Meanwhile, the water level in Lake Lanier remains close to the record low reached in December.

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City planning

Harlem reborn

Mar 13th 2008 | NEW YORK
From The Economist print edition

A dream is no longer deferred

WALK along 125th Street in Harlem, and it is hard not to get swept up in the history of the place. Many buildings still stand from the 1920s, when Harlem was the centre of a thriving black culture. Its side streets are lined with beautiful brownstone houses. On 125th Street itself are legendary buildings: the Apollo Theatre, where Ella Fitzgerald first sang, and Theresa Towers, where Fidel Castro met Nikita Khrushchev in 1960.

Yet it is also easy to see where Harlem has failed. Average incomes trail the rest of New York's. Although a few national chain stores have moved into the area over the past decade, closed-up shops still abound.

Michael Bloomberg, New York's mayor, hopes to change this with the most sweeping rezoning of 125th Street since Kennedy was president. After working on the proposal for four years, the city's planning commission voted on March 10th to rezone some 24 blocks in and around 125th Street. The rezoning will allow at least one high-rise and more than 2,000 apartments as well as hotels, nightclubs and galleries. For the first time, it will set height limits and establish a plan for future development. It is hoped that the plan will create a cultural renaissance in Harlem as well as 8,000 badly needed jobs.

Not everyone is happy. Some 70 small businesses could be forced to close and some historic buildings could be demolished. Critics fear long-term residents will be priced out of their homes. Gentrification over the past decade has certainly contributed to the increased cost of housing in Harlem. Others fear the neighbourhood's character will be irreparably changed because of luxury housing. The city's planning commission thinks the fears are unfounded, as 90% of the housing is rent-protected.

Julia Vitullo-Martin of the Manhattan Institute thinks the proposal doesn't go far enough. The first big office building to be built in Harlem in 40 years, which will be the headquarters of Major League Baseball, could be taller. But she understands critics' concerns: the proposal comes on the heels of last year's approval of Columbia University's plans for a new $7 billion campus in West Harlem. The city council will vote on the 125th Street proposal by April 30th.

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Lexington

The hypocrites' club

Mar 13th 2008
From The Economist print edition

Now with a new diamond-level member

Illustration by Kevin Kallaugher

ELIOT SPITZER is a hard man to defend. He was the most self-righteous politician in America—which is saying something—and an arrogant bully with it. If anybody deserves the opprobrium that is being poured on his head this week, following the *New York Times*'s revelation that he has a taste for expensive prostitutes, then it is Mr Spitzer.

As New York's attorney-general, he perfected the art of threatening Wall Street types with criminal prosecution unless they paid huge settlements; as New York's governor, he tried to drive a steamroller over anybody who got in his way, and consequently proved a big disappointment after taking office last year following a landslide victory. Even before his spectacular fall this week, his governorship seemed badly damaged. His promises to clean up Albany politics had borne no fruit and his proposal to give illegal immigrants driving licences had exploded in his face. He leaves plans for congestion charging in New York City up in the air, along with the state budget. A man who liked nothing more than braying about “betrayals of the public trust” and “shocking” and “criminal” behaviour has admitted to the former and may be charged with the latter.

Mr Spitzer had no interest in the distinction between “public” and “private”. He prosecuted “prostitution rings” as vehemently as he fought other forms of crime. His aides circulated unfounded allegations that Richard Grasso, who was the head of the New York Stock Exchange and one of Mr Spitzer's many bugbears, was sleeping with his secretary.

It is hardly surprising, then, that the country is enjoying a fit of *Spitzenfreude*—and that Wall Street's trading floors are decorated with photoshopped pictures of him cavorting with bodacious babes in various states of undress. Some people have even attributed the markets' mid-week bounce to glee over Mr Spitzer, rather than to the $200 billion shovelled their way by the Fed.

But distaste for Mr Spitzer—or keen pleasure in seeing a hypocrite hoist with his own petard—should blind no one to the fact that the whole affair is a crock of nonsense. What business is it of the federal government what Mr Spitzer got up to in Room 871 of the Mayflower Hotel in Washington, DC?

Defenders of America's tough laws on prostitution argue that it goes hand-in-glove with many other forms of crime (sex-trafficking, drug-trafficking, gangsterism). But surely this is an argument for focusing

on those heinous crimes rather than trying to prevent an activity that is as old as human society. Besides, if prostitution were not criminalised, the victims of such abuses would feel much less wary of going to the police about them.

America, of course, is not the only country that produces spectacles like the one enjoyed this week. The British tabloids like nothing more than catching a politician with his trousers down (though British headline-writers would be sacked for such feeble offerings as “New York's Naked Emperor”, from the *New York Post*). But America manages to be more unbalanced than other countries. This is partly because its legal system is out of control—an unstoppable clanking machine that has lost any ability to “draw the line” or respect “common sense” (to echo the titles of two books by Philip Howard, a New York lawyer).

The government, which began with a straightforward investigation of Mr Spitzer's finances (the authorities initially suspected him of corruption), ended up devoting considerable resources to his favoured “prostitution ring”, the Emperor's Club VIP—resources that might have been spent on something more urgent, such as looking for terrorists. It went to the trouble of obtaining a federal wire-tap and examining thousands of e-mails. All sorts of draconian punishments are now possible for Mr Spitzer. He could get a year in prison for violating a 1910 federal statute, the Mann act, which prohibits crossing state lines for “immoral purposes”. (Mr Spitzer bought “Kristen” a train ticket to travel from New York to Washington, DC.) He could get five years for arranging his finances to conceal his payments to the agency.

Revisiting Salem

American history is littered with examples of puritanism deranging the law, from the Salem witch trials onwards. Anthony Comstock, a 19th-century anti-porn campaigner, used his position as a postal inspector to seize 50 tons of books and 4m pictures. He boasted that he was responsible for 4,000 arrests during his career and 15 suicides. Under Prohibition people could be imprisoned for life for consuming alcohol.

Puritanism continues to stalk the country in new guises. The most dramatic example is America's new version of Prohibition—a “war on drugs” that helps explain why one in 100 American adults are in prison. But there are plenty of humbler examples. Schools impose zero-tolerance rules that result in expulsion for minor offences. The citizens of Texas may not buy dildos. Americans are banned from drinking until they are 21.

The combination of legalism and puritanism invariably produces the same dismal results. It creates expensive government bureaucracies that seize on any excuse—rules relating to inter-state commerce are a particular favourite—to extend their powers to boss people about or spy on them. It throws up swivel-eyed zealots who pursue their manias with little sense of proportion or decency (remember Kenneth Starr). And it ends by devouring its children. Mr Spitzer is only the latest in an endless line of self-righteous crusaders impaled on their own swords.

He certainly had no choice but to resign (as he did on March 12th) if, as it seems, he broke the law. But that still leaves the bigger question of whether the law is an ass. George Bernard Shaw once defined “Comstockery” as “the world's standing joke at the expense of the United States”; but it is hardly a joke for the people who are caught in its tentacles. There are enough real problems for America's law-enforcement officials to worry about.

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Colombia and its neighbours

Peace in our time, on the box

Mar 13th 2008 | BOGOTÁ AND CARACAS
From The Economist print edition

Reuters

But it may well prove to be as phoney as the war

Get article background

A WEEK after it began, the diplomatic and military stand-off between Colombia and its neighbours ended in scenes reminiscent of a Latin-American soap opera. At a summit on March 7th in Santo Domingo, the capital of the Dominican Republic, transmitted live throughout the region, Colombia's president, Álvaro Uribe, managed to restore diplomatic relations with Ecuador, Venezuela and Nicaragua. Relations had been severed after he ordered a bombing raid on a FARC guerrilla camp just inside Ecuador.

After reiterating his apology for violating Ecuadorian sovereignty, Mr Uribe went on to condemn the crimes being committed in Colombia by what he called “the sinister terrorists” of the FARC, whom his three neighbours view as closer to freedom fighters. Hugo Chávez, Venezuela's president, responded with a conciliatory speech, backing down from earlier talk of war. Mr Uribe took this as his cue to circle the conference room, shaking hands and slapping backs. Even a scowling Rafael Correa, Ecuador's president, agreed to declare an end to hostilities. And, in a remarkably harmonious exchange, Mr Uribe and Nicaragua's president, Daniel Ortega, seemed to resolve their bilateral differences in about 90 seconds flat.

If it seems too good to be true, it probably is. The peace will surely prove as phoney as the “war” that preceded it, which featured both Ecuador and Venezuela moving troops to their borders with Colombia. Many Colombians reckon it is Messrs Chávez and Correa who should be apologising: the contents of three laptop computers allegedly belonging to the FARC leader, Raúl Reyes, killed in Colombia's raid on the rebel camp, appear to confirm that Venezuela and Ecuador had close political contacts—or worse—with the FARC, an unreconstructed Marxist group involved in kidnapping and drug-trafficking, which both the European Union and the United States class as a terrorist group.

Mr Chávez, who recently called for the FARC to be recognised as legitimate belligerents protected under the Geneva Conventions, described Mr Reyes's killing as a “cowardly murder”. But he failed to win support at home and elsewhere in the region for his decision to wade into what was an essentially bilateral incident. Brazil's president, Luiz Inácio Lula da Silva, for example, did not accept or return several phone calls from Mr Chávez during the stand-off. Venezuela and its allies have denied giving aid and comfort to the guerrillas, and Mr Chávez has claimed credit for “restoring peace to South America”. But the underlying conflict remains.

For Mr Uribe, the information reportedly found on the computers (to be examined by experts from

Interpol) is a precious gift. He has agreed not to use it (as he had first threatened) to substantiate a case against Mr Chávez before the International Criminal Court. But many observers believe it was the strong hand this dealt him in Santo Domingo, rather than any real vocation for peace on the part of his neighbours, that brought about the climb-down.

Among the juicy titbits allegedly found on the computers are a $20,000 campaign contribution from the FARC to Rafael Correa; a putative deal between the rebels and Mr Chávez that would have netted them $300m and several hundred used rifles; and attempts by the FARC to obtain uranium for a “dirty bomb” and surface-to-air missiles to neutralise Colombia's helicopter fleet—a crucial weapon in the army's recent successes against the guerrillas. Mr Reyes is also said to have recorded his thoughts on how hostage releases, co-ordinated with Mr Chávez and a Colombian senator, would help them all politically.

Within days of killing Mr Reyes, the government had another stroke of luck: Iván Ríos, a second member of the FARC's seven-man commanding secretariat, was killed, this time by his own bodyguard. After taking Mr Ríos's passport, ID card and another computer, as well as chopping off his victim's hand to prove his death, the bodyguard carted his trophy to the nearest army post and gave himself up.

This incident is potentially even more serious for the FARC than Mr Reyes's death. The computer contained much less explosive material, though it did give details of a planned attack on the Medellín metro. But the effect on guerrilla morale of such high-level betrayal could be devastating. The guerrillas are already on the defensive, and if desertions were to spread, the retreat could become a rout.

Meanwhile, the Organisation of American States (OAS) has set up an inquiry into the Colombia/Ecuador border incident. But its decision not to tackle head-on the issue of the alleged computer data, pleading lack of expertise, suggests that it is unwilling to go to the heart of the problem in the region. Laura Gil, an international-relations consultant in Bogotá, deems the reconciliation to be “very fragile”.

Some kind of multilateral border-verification mission will be required to prevent further incidents. Ecuador has suggested that UN peacekeeping troops be brought in, and Mr Uribe has not rejected the idea, though the OAS secretary-general, José Miguel Insulza, reckons it would be “very difficult” to achieve.

Having emerged, so far, with little more than a slap on the wrist after a highly risky and controversial operation, Mr Uribe is ahead on points. He is unlikely to risk another such raid. But the fault-line running through the Andes seems bound to produce more tremors before long.

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AIDS in Brazil

A portrait in red

Mar 13th 2008 | SÃO PAULO
From The Economist print edition

One of the world's most successful AIDS programmes faces new problems

BRAZIL'S government is accustomed to being lampooned for being wasteful, ineffectual and corrupt. Occasionally, though, it does something really well. Keeping HIV/AIDS under control in a country where sex rivals football as the national sport is an impressive achievement, and over the past 20 years the government has done just that. Now, however, the disease has spread across Brazil (see maps). Although the total number of cases remains low at 620,000, representing 0.6% of those aged 15-49, the change in the profile of sufferers is taking the fight to places where it will be much harder to win.

“The epidemic has now taken the contours of the general population,” says Mariângela Simão, who runs the federal government's AIDS programme in Brasília, the capital. “It has become a portrait of Brazil.”

Brazil's epidemic began life among gay men in the south-east of the country, probably after travelling south from the United States rather than west from Africa. Had the virus not affected some white men living in the country's most prosperous region, the response might have been less energetic, some suggest under their breath. Thankfully, it was energetic, and it has taken three forms.

First, there has always been an insistence on the need to wear condoms, particularly at carnival time (when the usual supply of free prophylactics increases by 40%). The World Bank recently helped the government to buy a billion condoms (for 190m inhabitants)—around a tenth of the world's total supply. It took a year to find factories with sufficient capacity and the right quality controls to fill the order.

Second, the government funds free treatment for anyone with AIDS. This has involved side-stepping patents on anti-retroviral drugs to keep the bill down. Brazil saved an estimated $30m last year through the compulsory licensing of Efavirenz, a drug developed by Merck. But this strategy has its limits: the launch onto the market of one new drug has been delayed despite undergoing some clinical trials in Brazil.

Third, NGOs have been good at publicising the cause and at holding federal and local governments to their promises. This is particularly important in the north and north-east of the country where the disease is spreading fastest, and where some politicians have a semi-feudal relationship with voters. Cristina Pimenta, head of the Brazilian Interdisciplinary AIDS Association, says that NGOs are also now focused on making sure women know about the disease, get tested and, if necessary, get treated. During this year's carnival in Pernambuco, a poor state in the north-east, a government campaign was aimed almost exclusively at women.

As AIDS has spread through Brazil, it has gone from being an almost exclusively male disease to one that does not discriminate by sex. The responsibility for this lies in drug users sharing dirty needles and bisexual men—35% of male HIV/AIDS sufferers who have sex with other men say they also sleep with women.

As a result, women now account for ten out of every 25 new cases. Among young teenagers, more girls have the disease than boys. Women are less likely to be aware that they are at risk, too. According to one study, while 80% of men say they use a condom during casual sex, only 40% of women say their partners do. (There may be some lying here, as this suggests that the unprotected 20% of men get very little sleep. But it points to a real problem.) Brazil is still an overwhelmingly Catholic country where abortion is illegal. Persuading women in places far from the country's cosmopolitan big cities that they must get their partners to use condoms is hard.

Diagnosing people with HIV/AIDS and making sure they take their medication in the correct way has also got harder with the geographic spread of the disease. Brazil's health-care system is very patchy, as a recent report by the AIDS ministry for the UN shows. Victims in the north-east of the country are significantly less likely to be diagnosed than those in the south-east. For every 100,000 inhabitants in the south-east, 27 will have an AIDS test (this excludes pregnant women, who are frequently tested), compared with just 17 in the north-east. People with HIV/AIDS live longer in the south-east than they do in the north-east. And so on.

The risk is that people who do not follow their treatment correctly then develop drug-resistant strains of the virus. The disease would then become even more expensive to treat as newer drugs are required. This would come on top of the cost of regular health care for sufferers, who tend to need treatment for other health problems too. None of which means there is anything inevitable about AIDS spreading even further in Brazil. But from here on, it will all get a lot tougher.

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Canada

Please buy our dirty oil

Mar 13th 2008 | OTTAWA
From The Economist print edition

A new American law could limit oil-sands production in Alberta

CANADIANS like to think that although they are the junior partner in their trade relations with the United States, the 174 billion barrels of proven reserves in the oil sands of Alberta provide a powerful ace up their sleeve in any dealings with their energy-hungry neighbour. That belief has now been shaken by an American law that appears to prohibit American government agencies from buying crude produced in the oil sands of the western province.

The Energy Independence and Security Act 2007 did not set out to discriminate against Canada, America's biggest supplier of oil. But that is the effect of banning federal agencies from buying alternative or synthetic fuel, including that from non-conventional sources, if their production and use result in more greenhouse gases than conventional oil. Transforming Alberta's tarry muck into a barrel of oil is an energy-intensive process that produces about three times the emissions of a barrel of conventional light sweet crude.

Having woken belatedly to the danger, the Canadian government is now scrambling to secure an exception. Michael Wilson, Canada's ambassador in Washington, has written to America's secretary of defence, Robert Gates (whose department is a big purchaser of Canadian oil), stressing American dependence on Canadian oil, electricity, natural gas and uranium imports, and noting that some of the biggest players in the Alberta oil patch are American companies. Mr Wilson added plaintively that both George Bush and his energy secretary, Samuel Bodman, have publicly welcomed expanded oil-sands production, given the increased contribution to American energy security.

John Baird, the Canadian environment minister, referred this week to the American move when he unveiled new proposals to reduce industrial emissions in Canada, including the oil sands, by 20% by 2020. Big states like California were making similar pronouncements, he told reporters. The oil sands were an important national resource, but had to be expanded in an environmentally friendly way.

The fear in Canada is that the American purchasing restrictions, which at present apply only to federal agencies, is the start of a wholesale shift to greener as well as more protectionist policies under a Congress and potentially a White House controlled by the Democrats. With energy exports, mainly from Alberta, driving the Canadian economy, this is not a happy thought for Canadians.

Yet environmentalists point out that Canada is now paying for its own foot-dragging at the federal level on green initiatives. Having signed the Kyoto agreement under a previous Liberal government, Canada did little to stop its emissions rising. They are now almost 35% above the Kyoto target. And although Mr Baird likes to describe his plan as tough, it will not bring Canada into line with Kyoto. The rules for the oil sands, now the fastest growing source of greenhouse gases, have yet to be finalised and will not come into force until 2010. Furthermore, they rely on carbon capture, a promising but unproven technology.

The vagueness of the proposed federal rules did not stop the premier of Alberta, Ed Stelmach, from giving a defiant warning that he will stand up for the interests of Albertans (read oil industry) and will be examining the constitution to ensure that the federal government's proposed plan does not intrude on provincial jurisdiction. His province has one of the weakest environmental regimes in Canada.

Although the Canadian embassy says that there has been no official response to Mr Wilson's letter, there are reports of talks going on in Washington aimed at addressing Canada's concerns. But even if a deal is reached with the outgoing Bush administration, any exception for Canada may be short-lived if green-tinged Democrats take the White House in November.

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The Caribbean

Crown and Anchor

Mar 13th 2008 | PORT OF SPAIN
From The Economist print edition

The staying power of the British monarchy in its Caribbean ex-colonies

IT WAS the Bob Marley Museum in Kingston, Jamaica's capital, on March 12th for the heir to Britain's throne, then some inner-city regeneration projects, with a rainforest reserve to follow later. “If the queen was here there'd be even more hoopla,” one Kingstonian said. “She's had a bit of a resurgence lately; she owes it all to Helen Mirren. When it's Fergie, the media goes berserk.”

With Prince Charles and Camilla, it has been more quiet diplomacy than media glitz. After stop-offs at Trinidad and Tobago, St Lucia and the British overseas territory of Montserrat, Jamaica is the last leg of the royal couple's 11-day Caribbean tour on a vast 250-foot (75 metres) chartered yacht. The British government is footing the bill, with a useful discount on the usual $80,000 daily charge. It has also set the agenda for the prince's talks: climate change, grassroots globalisation and backing for tackling drugs.

Strictly speaking, this is not exactly a foreign trip for the prince. Twenty-seven years after the last of Britain's ex-colonies in the Caribbean gained independence, Elizabeth II remains queen and head of state in almost all of them, with Charles as the next in line. But, as in Britain, it is a largely ceremonial role, performed in the Caribbean islands by a governor-general, leaving an elected prime minister and his government to do the real stuff. Ten of the region's ex-colonies, including Dominica and Trinidad and Tobago, the only two to have ditched the monarch, still turn to the queen's Privy Council in London as their last court of appeal.

Across the region a scatter of Princess Margarets and Queen Elizabeths are to be found among the names of schools, roads and hospitals, suggesting a continuing link with the British crown. But ardent royalists are rare. Indeed, for some people in the Caribbean the tie to an elderly, white head of state who lives on the far side of a great ocean is a blot on their national pride. Yet, as in Australia and Canada, the monarchy has staying power. In 1999 P.J. Patterson, then Jamaica's prime minister, promised a republic by 2001. When he stepped down in 2006, the queen was still in place. It is a similar tale in Barbados and a necklace of other islands.

Why? In part because switching to a republic raises awkward issues. When a governor-general retires, the prime minister chooses his successor. Voters accept that. Change the job title to president and the system sounds less democratic.

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Malaysia's election upset

Anwar overturns the apple cart

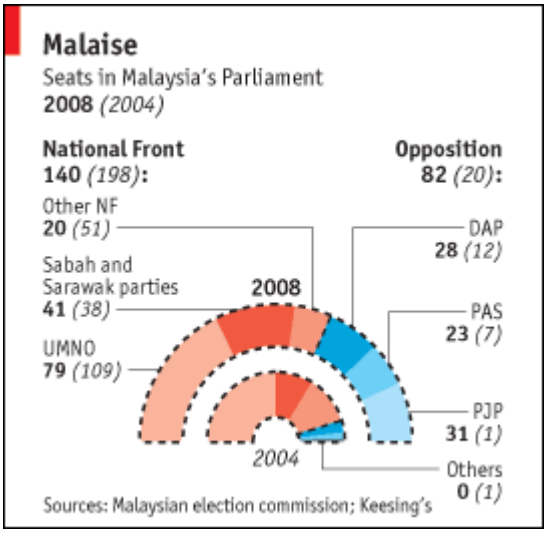
Mar 13th 2008 | KUALA LUMPUR
From The Economist print edition

AFP

A new political game—and the players struggle to work out the rules

THE bravest face the government can put on it is a crestfallen one. The result of the election of March 8th was “a huge setback”, admits Khairy Jamaluddin, a leader of the youth wing of the United Malays National Organisation, UMNO, which dominates the coalition that has ruled Malaysia since independence. The reason for Mr Khairy's gloom may not be immediately apparent. He won his seat. UMNO is still much the biggest party in the federal Parliament, where its coalition, the National Front, has a thumping majority (see chart). The Front still forms the government in eight of Malaysia's 13 states. But the huge swing against it has shaken Malaysia's rulers and put in doubt the system of racially-based politics on which their power depends.

Before the election only one state, Kelantan, in the relatively backward north-east of the peninsula, was in opposition control. Now bigger and richer Penang, Selangor, Perak and Kedah have fallen. And at the centre, the Front lost the two-thirds parliamentary majority it has enjoyed since 1969. This matters in practical terms since the Front can no longer override legislation passed by the states or amend the constitution. Hundreds of constitutional changes—mostly trivial, but some that strengthen the power of the executive branch—have been incorporated into law since independence in 1957. More important still was the symbolic impact of losing its two-thirds majority. The prime minister, Abdullah Badawi, knowing he could not repeat the landslide he achieved in 2004, had set this as the electoral winning-post. He fell eight seats short.

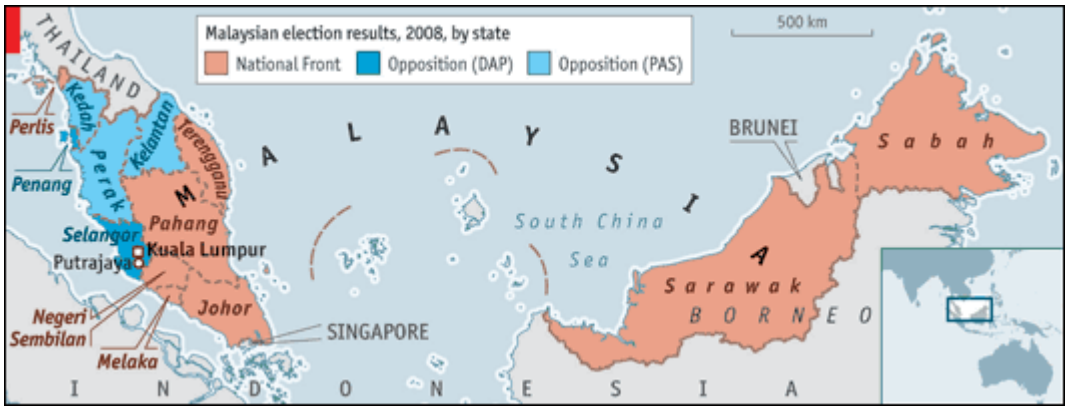


The swing against him partly reflects the high hopes of four years ago. After 22 years of rule by the abrasive and authoritarian Mahathir Mohamad, Mr Badawi was seen as more conciliatory and more committed to tackling corruption. He has indeed offered a less acerbic style. But few believe corruption has lessened. Instead, there has been a series of ugly scandals. And the high-flying Mr Khairy, Mr Badawi's son-in-law (and a former intern at *The Economist*), has become what one observer calls a “walking, talking, boasting” symbol of nepotism.

Chinese Malaysians (25% of the population) and Indians (8%) turned against the Front's ethnic-minority

parties. Indians are especially disgruntled. M. Manoharan, an ethnic-Indian lawyer, was elected to the state assembly of Selangor, despite being detained without charge under the Internal Security Act after a street protest last November. He was elected in a predominantly ethnic-Chinese constituency.

Minorities' faith in UMNO was dented when party leaders waved the *kris*, a traditional Malay sword, at conferences in 2005 and 2006. The implicit threat of violence to protect Malay interests recalled bloody race riots in 1969, which followed a strong opposition showing at the polls. Fears remain that UMNO supporters might stir up trouble. But despite some inflammatory text messages spread by mobile phone, Malaysia has remained admirably calm.



Many Chinese Malaysians have tolerated the New Economic Policy (NEP), introduced in 1971 to redistribute wealth to the poorer Malay majority, as a guarantor of communal harmony at a time when all ethnic groups were getting richer. Now even some Malay voters appear to have turned against it, seeing it as an excuse for cronyism and corruption. Some voted for the opposition, a loose alliance of three parties, which called the NEP obsolete and, on taking power in Penang, has started to dismantle it, saying its provisions will not apply to state-government contracts.

The forging of this alliance is the other reason for the opposition's breakthrough. The biggest Malay opposition party is the Parti Islam Se-Malaysia, known as PAS. Traditionally it called for Malaysia to become an Islamic state. This deterred non-Muslims from voting for the opposition at all. In this election, however, PAS toned down its Islamist rhetoric, and teamed up with two secular parties—the Democratic Action Party, whose base is predominantly Chinese, and the People's Justice Party, the PJP, led by Anwar Ibrahim. Mr Anwar is a former deputy prime minister, who spent six years in jail after falling out with Dr Mahathir.

Still banned from public office until April (one reason the election was held this month), Mr Anwar is now in practice leader of the opposition, as well as of Malaysia's first truly multiracial party. A number of successful PJP candidates, who include Mr Anwar's wife and daughter, have offered to make way for him in a by-election. But his coalition will be fractious. It is already squabbling about forming a government in Perak. And he says attempts have begun to lure away PJP members in the hope of restoring the government's two-thirds majority.

For his part, Mr Badawi has so far ignored calls for his resignation, coming most bitterly from the man who installed him as prime minister, Dr Mahathir. But he may well face a challenge at UMNO's general assembly later this year. In his favour, the obvious successor, Najib Razak, the deputy prime minister, is just as closely implicated in the scandals. But Mr Badawi seems unlikely to last beyond the next election. Chandra Muzaffar, a political scientist at the University of Science Malaysia in Penang, compares him to Cory Aquino in the Philippines and Bacharuddin Jusuf Habibie in Indonesia, both liberalising successors to long-serving strongmen, who were derided as ineffectual and turfed out. From the point of view of Malaysian democracy, if not of Mr Badawi, it is a rather encouraging analogy.

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The internet and Malaysian politics

The perils of modernity

Mar 13th 2008 | KUALA LUMPUR
From The Economist print edition

The government's cyber-enthusiasm comes back to haunt it

ON MARCH 8th Malaysia's electoral upset unfolded at glacial pace on government-owned television channels. As the approved pundits stumbled to grasp the stunning implications, some 500,000 Malaysians lost patience, and turned to *Malaysiakini*, an independent online newspaper, with 35 staff. It was faster and did not fight shy of trumpeting the opposition's excellent showing.

Even before election night, the internet had already played a big part in the vote. Malaysia has an unusual combination of high internet penetration and pliant mainstream media. It is therefore fertile ground for cyber-politics. According to the government's multimedia regulator, 3.9m of the country's 28m people have dial-up internet subscriptions and 1.2m broadband. Some 60% of the population, it reckons, use the internet. Even if that is an overestimate, the limitations of the mainstream media are enough to drive politics online.

Television hardly ever covers opposition rallies and speeches. But the online world is delightfully free. Anxious to make Malaysia a high-tech cyber-hub, the county's former prime minister, Mahathir Mohamad, exempted websites from the annual licensing requirements that help keep print publications deferential. The 1998 Communications and Multimedia Act decreed that there would be no censorship of the internet.

That does not, of course, make it a free-for-all. Strict laws—on defamation, for example—still apply. But the air of the blogosphere is refreshing after the stultifying fug of Malaysia's mainstream press. Jeff Ooi (www.jeffooi.com) and Tony Pua (tonypua.blogspot.com) were among several successful opposition candidates to have made their names as bloggers. Mr Pua thinks all parties underestimated the effects of “secondary access” to the internet, as news broken on the web—of opposition rallies, for example—was disseminated by word-of-mouth and mobile-phone text messages.

Most worrying for the government and the mainstream media, Malaysia is young. A new generation sees the internet as its primary news source. Founded in 1999 as a free site, *Malaysiakini* was forced to start charging in 2002, but was free for the election. In normal times, it has just 10,000 subscribers. But the election has been a great advertisement for it, as well as for democracy.

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Pakistan's politics

The lion lies down with the lamb

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Astounding many, two old rivals say they will rule together

AFP

Zardari, Sharif and guiding spirit

CYNICS have been silenced, at least for now. They said Pakistan's two biggest and always quarrelling political parties, the Pakistan People's Party (PPP) and the Pakistan Muslim League-Nawaz (PML (N)), could not govern together. But on March 9th their respective leaders, Asif Zardari and Nawaz Sharif, the biggest winners in a general election held last month, declared that they would do so.

The Murree declaration, as their agreement has been called, after the pretty hill-station near Islamabad where the two men met, is a promise to share power in the federal government and in Punjab, Pakistan's richest province. As an act of political co-operation, this was remarkable. After all, the PPP, which won the most votes in the election, was in a position to form a government in Islamabad with other allies, as the PML(N) could have done in Punjab. Yet it is difficult to rule Pakistan without also controlling Punjab. That was the experience of Mr Zardari's late wife, Benazir Bhutto, a two-time former prime minister murdered on the campaign trail in December. Her first government collapsed in 1990 partly under duress from the then leader of Punjab—Mr Sharif.

So Mr Zardari has been wise to accommodate an erstwhile rival. Thereby he might seem to have accepted one of Mr Sharif's dearest demands: the restoration of 60 judges sacked by President Pervez Musharraf during the state of emergency called in November. Unlike the more conciliatory Mr Zardari, Mr Sharif (whose electoral symbol was a lion) has pitched himself into fierce opposition to ex-General Musharraf, who imprisoned him in 1999. In an ominous sign for the demobbed president, the two party leaders vowed that within 30 days of forming a government, they would pass a parliamentary resolution restoring the fallen judges.

Mr Sharif has also made concessions. After his party came a surprisingly close second in the poll, he decreed that none of its members would enter Parliament under a constitution that Mr Musharraf has several times rewritten—or enter the government while Mr Musharraf remained president. He has backed down on both. And he may not get his wish to see the reinstatement of the fallen judges. As things stand, only a constitutional amendment can do this, and the PPP and PML(N) do not have the necessary majority in Parliament's upper house. For the same reason, they would not be able to impeach Mr Musharraf—as Mr Sharif has sworn to do.

Legal activists want the next government to restore the judges by decree. The judges might then legitimise this legally dubious step—or so it is argued. They might also re-examine the legality of Mr Musharraf's presidential re-election last year, which the Supreme Court had been due to rule on in November when Mr Musharraf demolished it.

But this ploy could backfire on Pakistan's new leaders. The current Supreme Court justices, hand-picked stooges of Mr Musharraf, might, for example, order the army to intervene to save their hides. On March 6th, however, the army chief, General Ashfaq Kayani, said he hoped the army would not be dragged into any “unnecessary controversy”. And the Murree declaration, which says nothing about Mr Musharraf, seems more a statement of intent to restore the judges than a promise. Pakistan's next leader will anyway have more to worry about—terrorism, for example—than the future of an unloved former dictator. Twin suicide blasts in Lahore on March 11th killed 24 and injured over 100.

Parliament is expected to convene on March 17th, and a prime minister should be nominated by March 20th. It will not be Mr Zardari or Mr Sharif, both of whom were barred from contesting the election. It is

likely to be a trusted PPP friend of Mr Zardari—pending, perhaps, his own imminent victory in a by-election, and ascent to his dead wife's rightful throne.

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India and Pakistan

He came in from the cold

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A tale of detention and detente

A WHITE-BEARDED old man has returned to India, and to the glare of a hundred newspaper cameras, after 35 years in a Pakistani jail. Kashmir Singh was arrested in 1973 on spying charges and the Indian media, quick to cock a snook at their struggling neighbour, suggested a cruel injustice had been done to this travelling “salesman”. But speaking to journalists shortly after embracing his “still beautiful” wife and noting the astonishing number of motor cars about, Mr Singh disabused them of their indignation. Raging at the Indian government for leaving his family in poverty, he declared he had indeed been a spy. “I did the duty assigned to me as a spy,” he told journalists. “I did not open my mouth for 35 years.”

India and Pakistan have fought three wars and numerous near-wars in the past 60 years. Their jails are dotted with men arrested on spying charges. India says 600 of its nationals languish in Pakistani jails; Pakistan says India has 200 of its men. Though a peace process was launched in 2004, the two countries are still believed to conduct intelligence missions across the border and to make arrests on either side.

Mr Singh's release was a sign of something better. Ansar Burney, Pakistan's human-rights minister, had discovered Mr Singh's plight himself. He had pleaded with President Pervez Musharraf for his release. At the border, the two men had hugged, and Mr Singh had wished that all Indians and Pakistanis would get on as well. Later, hearing of Mr Singh's confession, Mr Burney said he was shocked. But his actions were nonetheless in line with the peace process that has improved ties and reduced suspicions on both sides. Indeed, the thaw may be happening even faster in Pakistan, perhaps because its other concerns—terrorism, political uncertainty—seem even more pressing.

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The death penalty in Japan

Just plead guilty and die

Mar 13th 2008 | TOKYO
From The Economist print edition

The wheels start to wobble on Japan's judicial juggernaut

IT WAS a rarity for Japan: two notable acquittals within a month. On March 5th Mitsuko Katagishi, a 60-year-old from southern Kyushu island, was acquitted of charges that she had killed her brother and set fire to his house. The case against her rested on prosecution claims that she had confessed her crime to a cellmate during months in police detention. The presiding judge chided the police for planting the cellmate and dismissed the evidence as not credible. In a country with a conviction rate of over 99%—and where even defence lawyers urge clients to plead guilty—this was a deep embarrassment.

It follows a farcical trial in February of 11 mainly elderly defendants accused of vote-buying in Kagoshima, also on Kyushu. The trial collapsed when it became plain that the police had fabricated the evidence—though not before one defendant had died and another been subjected to over 700 hours of interrogation and 400 days in detention. All the accused had been ground down until they signed confessions of guilt.

In response to these problems, the authorities have closed ranks. Japan's justice minister, Kunio Hatoyama, argues with casuistic skill that the vote-buying case cannot be described as a false prosecution: that would imply the real culprits are still at large when, happily for all, there are no culprits at all. But such complacency is wearing thin. Two changes are afoot in Japan's criminal-justice system. One is the introduction next year of trials in which a lay jury of six will join three judges to adjudicate in criminal cases, with convictions secured by majority vote. This may encourage more popular involvement in the criminal-justice system. The other is the emergence of establishment figures prepared to question the shortcomings of that system, and especially of the death penalty, which means victims pay an irreversible price for miscarriages of justice.

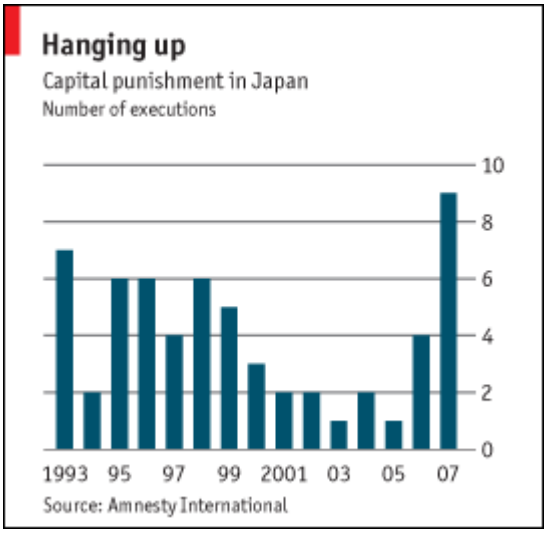
Shizuka Kamei, a former chief in the National Police Agency and now a member of the Diet (parliament), describes Japan's high conviction rate as “abnormal”. The police, he says, are under more pressure to find any culprit for a crime than to find the real one. To save face, senior officers are reluctant to highlight mistakes made by subordinates. Worse, prosecutors are not bound to disclose material that they choose not to use in court. Many false prosecutions never come to light.

The notion of being innocent until proven guilty is not strong in Japan. Mr Hatoyama calls it “an idea which I want to constrain”. But confessions are important and the courts rely heavily upon them. Apart from helping secure convictions, they are widely interpreted as expressions of remorse. A defendant not only risks a longer sentence if he insists he is innocent, he is also much less likely to be granted bail before trial—often remaining isolated in police custody, without access to counsel, for long enough to confess. Toshiko Terada, a private lawyer, calls this *hitojichi shiho*—hostage justice. Perversely, where little supporting evidence exists, the system helps hardened criminals, who know that if they do not confess they are unlikely to be indicted. Innocents, on the other hand, may crack—as in the Kagoshima case, or in a notorious 2002 rape case when the accused confessed under pressure but was released last October after the real culprit came forward.

Growing concerns about such miscarriages have helped forge an unlikely parliamentary alliance between politicians of the left pushing to abolish the death penalty, Mr Kamei (who in other areas is an arch-conservative) and Koichi Kato, a former secretary-general of the ruling Liberal Democratic Party. Last year Japan executed nine people, compared with America's 42; it also has 106 people on death row. But its murder rate is only one-fifth that of America so its execution rate is roughly comparable. Some of Mr Hatoyama's predecessors have been unwilling to sign death warrants, but in the past 18 months executions have leapt (see chart), including several accused

who were elderly and infirm.

Executions take place in extreme secrecy under the auspices of the Justice Ministry. Prisoners are kept in near-isolation and are not usually informed that their time is up until less than an hour before the sentence is carried out—often after waiting for decades. The names of those executed were made public for the first time only in December. Not even Diet members may inspect a working gallows, and many people do not know that hanging is Japan's method of execution. Bureaucratic secrecy has served to suppress debate about the death penalty—and give ordinary people a sense that justice is something best left to the authorities.



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The My Lai massacre 40 years on

Not quite forgotten

Mar 13th 2008 | SON MY
From The Economist print edition

Revisiting a terrible day in Vietnamese and American history

VICTIMS' bodies were mutilated; women were gang-raped; a baby was used for target practice. The My Lai massacre, 40 years ago this weekend, was the worst atrocity by American forces in the Vietnam war. “Charlie Company” was sent to lay waste to four hamlets in Son My district suspected of harbouring Viet Cong guerrillas. It took more than a year for the truth about the slaughter of more than 500 civilians on March 16th 1968 to emerge. The subsequent trial was a whitewash. But it helped turn Americans against the war.

Now, a trickle of American veterans visits the site of the massacre and an accompanying museum nearby, hoping to exorcise their ghosts. Relations between Vietnam and America are good these days. Even before an American-led aid boycott was eased in 1993, the former foes were co-operating in tracking the remains of American soldiers who went missing in action.

But not all is well. The Vietnamese remain angry at the failure to compensate victims of Agent Orange, a defoliant sprayed by American forces which is suspected of causing cancer and birth defects. Some American victims of the chemical have already won compensation in an out-of-court settlement. In February, however, the United States second circuit court of appeal upheld an earlier ruling that Vietnamese victims had failed to prove their case against Agent Orange's makers.

Vietnam's foreign-ministry spokesman calls the ruling “erroneous and unfair”. As the country seeks foreign investment, putting development ahead of old enmities, much has been forgiven but not all has been forgotten.

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Taiwan

Where a common market is divisive

Mar 13th 2008 | TAIPEI
From The Economist print edition

Opening up to China becomes the island's main election issue

MOST countries cannot wait to clamber aboard the bandwagon of Chinese growth. Until now, Taiwan has been an exception: its desire to benefit from China's vibrant economy is moderated by fear of a rival that has threatened to invade it. But this seems to be changing. With a presidential election due on March 22nd, its two main parties are vying with one another to open up to the mainland.

In the past two months the governing Democratic Progressive Party (DPP), the more independence-minded of the two, has relaxed more and more restrictions on economic activity across the Taiwan Strait. It has allowed visits by Chinese tourists on international cruise ships, granted Chinese nationals married to Taiwanese citizens the right to work and is relaxing some restrictions on investment in China, including lifting a ban on indirect China-bound investment by local banks.

The opposition Kuomintang (KMT) has promised to go further still. Its candidate, Ma Ying-jeou, proposes a “Great China market” based, his party claims, on the European Union's common market. It would have the same free movement of goods and capital, but not free movement of people. The party also plans to acknowledge Chinese academic degrees, which the DPP opposes.

It may have gone too far. The DPP's presidential candidate, Frank Hsieh, calls the “Great China market” the “one-China market” at every opportunity. It is, he says, tantamount to surrendering to the Communists and would lead to Chinese workers and products flooding Taiwan. The Council of Labour Affairs, a government agency, reckons that every 100,000 Chinese workers in Taiwan would drive unemployment up by a percentage point. The DPP raises fears that Chinese investment in Taiwanese property would lead to a housing bubble and unaffordable prices.

The attacks seem to be working. The KMT had been ahead in opinion polls by double digits. The DPP claims to have narrowed the gap to 6-8%. The KMT has started to backtrack on its more far-reaching proposals, including the common market. Its position has been weakened by China itself. In February nearly 700 Chinese tourists arrived on a cruise ship. But after President Chen Shui-bian claimed that his efforts had paved the way for the new opening, the government in Beijing immediately said Chinese cruise passengers may not visit in future.

Some observers give warning that China would not transform Taiwan's economy, anyway. They say Hong Kong's momentum has declined as its economy has become more closely linked to China's. Others think Taiwan has no choice but to take what advantage it can of China's rise. Which of those perceptions is accepted by voters may well determine who wins the forthcoming vote.

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Demonstrations in Tibet

Monks on the march

Mar 13th 2008 | LHASA
From The Economist print edition

The most serious unrest in years shakes the Tibetan capital

AFP

They are being dealt with

IF THERE is one city in China where the authorities are truly worried about serious unrest that might spoil the Olympic games in Beijing in August, it is the Tibetan capital, Lhasa. Around the ancient monasteries and in the narrow streets of the city's old quarter, filled with the shuffle and drone of pilgrims murmuring their prayers, residents say that security is being tightened.

It usually is around this time of year. March 10th is often tense because it is the anniversary of a revolt in 1959 against Chinese rule in Tibet that was crushed by the Chinese army. The region's spiritual leader, the Dalai Lama, fled with many of his followers and has been living in exile in Dharamsala in India ever since. But this year there are reports that Tibetan monks, often at the forefront of anti-Chinese dissent, are becoming particularly restive.

Such reports are difficult to verify. The authorities rarely allow visits by Western journalists. Chinese officials say that regulations introduced last year aimed at reducing bureaucratic hurdles to reporting in China before and during the Olympics do not apply to Tibet. Very unusually, however, *The Economist* gained approval for a week-long trip, the start of which on March 12th coincided with the apparent increase in tension.

It seems to have begun on the anniversary itself, when police stopped an attempt by monks in Lhasa to demonstrate. This much has been confirmed by a Foreign Ministry spokesman in Beijing, who said monks from “some temples” had carried out an illegal activity on March 10th “under the instigation and encouragement of a small group of people.” He said they were “dealt with” according to the law.

About 300 monks seem to have been involved. Reuters news agency, reporting from Beijing, said that on the next day (March 11th) more than 600 monks gathered in Lhasa to demand the release of monks detained for protesting. It said tear-gas was used to disperse them. These incidents are among the biggest reported in the city in recent years.

Residents say that more uniformed and plainclothes police have been deployed around sensitive parts of the city. Policemen patrol the city centre close to the Jokhang Temple, one of the holiest sites of Tibetan Buddhism where several protests, often involving just a handful of people, have occurred over the years. One resident said some plainclothes police appeared to be disguising themselves as monks.

Most parts of China are unlikely to see the kind of political unrest that occurred in the build-up to the Mexico Olympics in 1968 and the Seoul Olympics in 1988. Tibet is an exception. The government's attempts to ensure stability by appealing to a sense of national pride are likely to prove far more difficult

in the Himalayan region because of its ambiguous relationship with China before Communist troops took control in 1950. The authorities are also worried about the impact of recent protests in Myanmar led by Buddhist monks.

Many Tibetans outside China hope to use the Olympic games to draw international attention to what they say are widespread human-rights abuses in their homeland. On March 13th police in northern India stopped a (largely symbolic) attempt by more than 100 exiles to march from the Dalai Lama's exiled home to Tibet to press their case.

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Israel and the Arabs

Bracing for the big one

Mar 13th 2008
From The Economist print edition

Despite a short, tantalising lull in Gaza, a wider war may be on the way

AFP

SO HAMAS and Israel can deter each other after all. That is one possible conclusion to draw from the lull that descended on the borders of the Gaza Strip a few days after Israel's mini-invasion in the first week of March, which killed more than 100 Palestinians, civilians as well as fighters. Soon after Israel withdrew, the rain of rockets that had been falling on Israel's southern towns slowed to a drizzle and then came to a stop that lasted for several days. Mahmoud Abbas, president of the Palestinian Authority in the West Bank, and Hamas's rival, said that the lull was the result of an agreement—a claim that Israel and Hamas were at first quick to deny. But whether it was the product of a deal, or just of a wary understanding between the adversaries, people on both sides of the border enjoyed a brief respite.

Can a respite be turned into something more durable? Much more hangs on the answer to this question than you may think. From afar—indeed, even from Tel Aviv—the makeshift rockets that land on Israeli border towns such as Sderot can look like a nuisance, not a mortal threat to the Jewish state. Fewer than half a dozen Israelis have been killed by rocket fire since Israel pulled its soldiers and settlers out of Gaza in 2005. And yet there are serious people in the region and the wider world who think the Gaza skirmishes could at any moment provoke a full many-fronted war, involving not just Israel and the Palestinians but Lebanon, Syria and, indirectly, Iran as well.

One veteran diplomat at the United Nations in New York outlines the following hypothetical but plausible scenario. Ehud Olmert, Israel's prime minister, finds he can no longer resist pressure to end the rocket fire, a job that military men say can be achieved, if at all, only by a ground invasion. But ground warfare against Hamas's guerrilla fighters in the teeming confines of Gaza will certainly kill many Palestinian civilians. That will tempt Hassan Nasrallah, the leader of Hizbullah in Lebanon, to help his fellow Islamists by opening a second front from Lebanon. Since Hizbullah's own “divine victory” against Israel in the summer of 2006, its arsenal of rockets is reported to have been more than replenished by its Syrian and Iranian mentors—and beefed up with sophisticated longer-range missiles.

Since that war, an international buffer force of almost 15,000 peacekeeping soldiers has been installed in southern Lebanon. But don't be soothed. They, in the private view of many of the providing governments, would become little more than hostages in the event of serious fighting. Hizbullah has kept most of its new rockets north of the Litani river, from where they can simply be fired into Israel over the peacekeepers' heads. At most, the peacekeepers would complicate another Israeli effort to defeat Hizbullah by launching another ground invasion of Lebanon.

Here is where this worst-case scenario turns truly nightmarish. Mr Olmert learnt in Lebanon that a

guerrilla army, especially one as well trained and armed as Hizbullah's, is hard to destroy. So there is in Israel a school of thought that advocates counter-attacking not only against Hizbullah but also against Syria, Mr Nasrallah's helper and armourer. The government of a state, goes the argument, will find it a lot harder than a non-state actor like Hizbullah did in 2006 to shrug off the sort of damage Israel inflicted on Lebanon's infrastructure. Syria's armed forces, moreover, are conventional—the kind that Israel thinks it knows how to beat. Israel's mysterious air raid in Syria last September may have been designed to show that it is not afraid of taking the Syrians on.

Will any of the foregoing really happen? A cynic might dismiss such apocalyptic speculation as an Israeli design to scare Hamas and its friends in Lebanon, Syria and Iran into stopping the rocket fire. Israel's defence minister, Ehud Barak, has after all been talking for months about the possibility of a “big operation” in Gaza, yet no such operation has materialised so far. He, Mr Olmert and Israel's generals are painfully aware that Gaza could become a quagmire for Israel, as south Lebanon did until Mr Barak, as prime minister, pulled Israel out in 2000.

On the other hand, even without the rocket fire, the prospect of Hamas building up a Hizbullah-like army in the Gaza Strip frightens many Israeli policymakers. That would give two potent militias officially dedicated to the destruction of the Jewish state the option of starting hostilities on two fronts at a time of their own choosing. As for the quagmire, some reports have it that Israel is already investigating the possibility of turning a Gaza “liberated” from Hamas over to a multinational force.

The danger in Gaza may explain an acceleration in diplomacy. Hard on the heels of Condoleezza Rice, America's secretary of state, Dick Cheney, its vice-president, is to visit the region on March 16th to meet the Saudi king as well as Messrs Olmert and Abbas. George Bush is talking once again about securing his “vision” of an independent Palestine at peace with Israel before he leaves office. But the talks between Mr Olmert and Mr Abbas that started after Mr Bush's get-together in Annapolis last November have been fitful, not least because they take place against a backdrop of disruptive violence.

On March 6th, for example, a Palestinian resident of Jerusalem entered a Jewish seminary with a machinegun and killed eight students. This week Israeli soldiers killed four Palestinian gunmen in Bethlehem, who Israel said were members of Islamic Jihad, one of the most violent Palestinian groups—whose response was a new rocket barrage from Gaza. Hamas insists that any ceasefire in Gaza must extend to the West Bank as well. But Israel claims it has a right to arrest and if necessary kill those who plan or mount lethal attacks on its citizens. Not for the first time, the military clock in the Middle East may be ticking faster than the political one.

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Sudan

Peacekeepers into the fray

Mar 13th 2008 | EL-FASHER
From The Economist print edition

The big UN force now arriving in Darfur will not bring peace at a stroke

DARFUR can seem eerily quiet from within the neat, well-scrubbed prefabs of the sprawling UN compound being swiftly erected on the outskirts of the region's capital, el-Fasher. Eventually, once it expands over the sand dunes, it is hoped that the base for the UN's African Mission in Darfur (UNAMID) will house the largest peacekeeping force in the world: 20,000 soldiers, and about 6,000 policemen.

Beyond the razor wire, however, it is a very different story. In some areas, the killings and destruction are as bad as ever, but the causes have changed dramatically since the Darfuris first rebelled against the Sudanese government in 2003. The tidy division between the two main rebel groups and the government soldiers with their proxy fighters, the Arab militias known as the *janjaweed*, has dissolved. The violence is now perpetrated by many more groups, with a tangle of motives. As a UN mediator puts it, the situation is “a mess”. All this will make UNAMID's task far harder than many first imagined.

For one thing, the new force, which officially took over from African Union (AU) peacekeepers on January 1st, is deploying in the middle of a full-blown war that has spilled from West Darfur across the border into Chad. In February Chadian rebels, supported and armed by Sudan's government, drove out of West Darfur in columns of converted pick-up trucks known as “technicals”, to try to topple President Idriss Déby, a former ally turned implacable foe of the Sudanese government. He survived, just, thanks largely to the intervention of his own proxy fighters, a Darfuri rebel group called the Justice and Equality Movement (JEM).

In the past few weeks Sudan's government has taken advantage of the absence of many JEM fighters in Chad to attack their home bases in Darfur, north of el-Geneina, West Darfur's capital (see map). The scorched-earth policy the government applied in its previous counter-insurgency campaign in Darfur has been evident again: attacks on villages by the *janjaweed*, preceded by an aerial bombardment. This has sent thousands more refugees fleeing to camps in Chad.

In this increasingly complex conflict, allegiances stretch across borders and shift from month to month. The rebel groups broke into several factions after a peace agreement signed in 2006 by the Sudan government and the largest rebel group quickly fell apart. They now sometimes fight each other. The Arab militias are less tightly controlled by the Sudanese government, not least because they have not been regularly paid. There has been fighting between them and the government forces, and between rival militias. As the old command structures have broken down, many fighters, on all sides, have

become bandits. The hijacked cars of foreign aid workers now turn up in Chad, where a car will sell for about $10,000.

There must be plenty of them. In 2007, 139 such vehicles were hijacked or stolen from compounds and 77 relief convoys looted; 147 aid workers were temporarily abducted. Since the beginning of the year the UN's World Food Programme alone has had 46 lorries hijacked; 23 of its drivers have been kidnapped. Last October three of its drivers were killed.

The worsening violence has restricted movement to the more remote rural areas, where people need help most. The UN's Children's Fund reports that in North Darfur, a comparatively peaceful part of the region, malnutrition, mortality rates and access to clean water have all worsened again after improving somewhat since the height of fighting in 2004. Another 300,000 or so people were displaced last year throughout Darfur. In ZamZam camp, just outside el-Fasher, almost 9,000 wretched people have arrived in recent months. The camp co-ordinator says some 5,000 have fled renewed fighting in the south; the rest are economic refugees, unable to feed themselves anymore.

The new UN force is unlikely to turn things around. Sudan's government seems determined to press on with its military campaign, especially in the west against the JEM and Chad's President Déby. That will create more refugees and handicap aid efforts in both Darfur and Chad. Columns of a hundred or more technicals and tanks have recently been seen heading west. In el-Geneina, recruits joining the Arab militias to fight in Chad are being offered one-off payments of $1,000. With lots of oil money to fund their own operations and those of their proxies, the Sudanese forces see no reason to let up yet.

The UN will not be able to deter military activity on such a scale, at any rate not for quite a while. For the present its force is based largely on what it has inherited from the AU, whose soldiers had become thoroughly demoralised under the AU's command. They had not been paid for months and 22 of them were killed last year.

Now please go out on patrol

This means that the first job of the UN's commanders is to cheer up the existing force, which has lost its appetite for anything but the safest of work. Contrary to some reports, the force has plenty of good equipment—but seems reluctant to use it.

The West's aid-giving governments, which are paying for most of the operation, are pinning their faith on a spine of experienced Western staff officers to make the force more active and effective. At the insistence of Sudan, its composition is still 97% African, but the hope is that the small non-African contingent, which is mostly Asian, can make a big difference.

More men should help too. An Egyptian battalion is expected next, followed by Ethiopian and Senegalese ones. Tanzanians, Ghanaians and Burundians are also expected to join the force. More than 100 Chinese engineers are already operating in Nyala. More military transport aircraft and attack helicopters would be a boon.

In the longer run, success will depend on the peace talks between the rebels and the government. These broke down after an abortive conference in Libya last October. A big obstacle is the splintering of the rebels into a confusion of factions, often for reasons of personal rivalry. One frustrated UN negotiator says that many of the former freedom fighters are now just opportunists—and have managed to make even the Sudanese government look constructive. Still, if the UN troops could provide some security, the rebels might try harder to forge a peace for them to keep.

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Uganda

Might the Lord's Resisters give up?

Mar 13th 2008 | GULU
From The Economist print edition

A rebel leader is being pressed to give up—but under which system of justice?

AFTER nearly two years of painfully slow progress, a flurry of activity has stirred the peace talks between Uganda's government and the rebels of the Lord's Resistance Army (LRA) against whom it has fought for more than 20 years. Negotiators say they have signed all remaining documents, including ones providing for demobilisation and a permanent ceasefire. A signing ceremony is said to be in the offing, dates are being discussed and a list of presidents due to attend has been splashed on the front pages of newspapers in Kampala, the capital. But a final deal is still elusive.

That is because the rebels are refusing to sign until the International Criminal Court (ICC) in The Hague drops charges of war crimes against the LRA's leader, Joseph Kony, and two other commanders. Though Uganda's government called in the ICC in the first place, it has since signed a pact with the rebels that is supposed to deliver justice through Uganda's own courts and traditional systems. Visiting London this week, Yoweri Museveni, Uganda's president, said: “What we have agreed with our people is that they should face traditional justice, which is more compensatory than a retributive system.”

The ICC, however, says it will continue to press its own case against the LRA leaders, who have been accused of the most appalling atrocities, unless Uganda can show that it is “willing and able” to try the men in accordance with international standards. It would then be up to the ICC's pre-trial chamber to decide whether to drop its charges. So far, the Ugandan government has not asked it to do so.

The LRA says it has been fighting for the disaffected Acholi people of northern Uganda (see map). Whatever the cause, it has terrorised the population, ravaged villages and kidnapped children to swell its ranks. Most Acholis loathe it. But many are angry about the ICC intervention too. “This ICC thing, we don't want it—we want peace,” says Grace Oyella, a seamstress in Gulu, the biggest town in the area. “They [the LRA] may have killed many people and we have lost our brothers, but if they refuse to allow them back they will just keep on doing this.”

Many Acholis prefer the idea of their own form of traditional justice, known as *mato oput*, to tackle crimes committed during the war. Under this system, the accused must recognise their crimes, ask for forgiveness and compensate victims. All involved then take part in a ceremony, drinking a bitter herbal concoction and eating together in a token of reconciliation. Acholi elders say that amid the chaos and lawlessness they have used their old ways to keep order. These, they insist, can deliver justice as well as peace.

But others are eager for revenge. Norbert Mao, a local Gulu official, says he doubts whether Acholis are

as forgiving as is often made out. Some former LRA fighters who have tried to return to their villages have been killed. Though *mato oput* helps deal with certain crimes, it is not designed for the perpetrators of mass atrocities, he says. Human-rights groups such as Amnesty International, Human Rights Watch and the International Federation for Human Rights agree, calling on Uganda, a party to the ICC, to honour its obligations to the court. Without justice, they argue, there can be no lasting peace.

Under the deal accepted by the rebels, the government is to try those accused of the more serious crimes before a special chamber in Uganda's High Court. But many doubt this will provide justice of a standard to satisfy the ICC judges. Uganda's existing courts are not known for impartiality or independence. In addition, a new law would have to be passed to allow trials for war crimes, and criteria would have to be drawn up to decide who should be tried under which system.

There is also no guarantee that the LRA would keep any agreements. In the past, it has broken them as fast as they have been signed. After more than 20 years in the bush, lording it over his fighters, multiple wives and reputed 200 children, Mr Kony, whom some call mad, might find the prospect of justice in Uganda just as unenticing as justice in The Hague.

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Kenya

A new dawn amid the golf carts

Mar 13th 2008 | NAIROBI
From The Economist print edition

Time to break with a corrupt past

THERE was applause at the Karen Country Club in Nairobi on March 9th, when Kenya's president, Mwai Kibaki, and prime minister-elect, Raila Odinga, sauntered down the sun-soaked first tee at the annual professional golf tournament. This was Cheshire Cat territory, the grins unlimited and undimmed, including from the two big men who until recently had been so opposed over a disputed election as to drag Kenya towards civil war. Mr Odinga called Mr Kibaki “your excellency”. Mr Kibaki raised polite laughter by suggesting young Kenyans should take up golf as a way to earn money.

After Kenya voted on December 27th in parliamentary and presidential elections, the tight and probably fraudulent result tested the country to breaking point. At least a thousand people were slaughtered and 300,000 made homeless. Yet for all the misery, it is possible that Kenya may emerge stronger and more united. Fighting is now restricted to land disputes in the Rift Valley, particularly around towering Mount Elgon, where the army is using helicopters and artillery to fight a local militia.

Although outside pressure helped, it was Kenyans themselves who forced the deal. Television pictures of young men brandishing machetes should be set against the doveish work of many other Kenyans. Leaders in business, the media, law and religion all worked hard for reconciliation. In this at least, Kenya did rather better than, say, the former Yugoslavia.

But will February's pact, sealed with the help of Kofi Annan, a former United Nations secretary-general, bring lasting calm? A power-sharing government is expected to be at work by the end of the month. Parliament will sit without an official opposition. This week it began to pass bills allowing for the creation of a new post of prime minister (to be filled by Mr Odinga), a law to work against tribalism, a panel to investigate the election, another to draft a new constitution, and a truth and justice commission to investigate political crimes, including a history of corruption ever since independence in 1963.

None of this will be easy. One question is what authority the prime minister will have. The opposition expected Mr Odinga to be almost the equal of Mr Kibaki, taking on many of the powers of the current presidency. But the head of the civil service, Francis Muthaura, says the prime minister will be only third in rank after Mr Kibaki and the vice-president, Kalonzo Musyoka—and that the president will keep all his existing responsibilities. That would diminish Mr Odinga and allow Mr Kibaki to retain his power of patronage.

The finer details will be clarified by the parliament, but the divvying up of ministries is likely to be resolved in Nairobi's back rooms, not least the Karen Club. The opposition wants the government to give up the powerful ministries it claimed after the election, including finance, justice and internal security. The government has rejected this. Compromise is likelier on the choice of the two deputy prime ministers.

In order to accommodate the rival factions, the new government will be big. But can a country riddled with corruption afford 38 government ministers? Moreover, a parliament without an opposition is hardly likely to excel at holding the government to account. Against that, say optimists, is the fact that 60% of the parliamentarians are new (23 cabinet ministers lost their seats in the election, mostly because they were seen as lazy or crooked, or both). Mr Odinga himself says the new lot are “young, progressive, clear-minded, and keen on change”.

They need to be. Not far from the Karen Club is Kibera, a slum of 600,000 people in an area only a little larger than an 18-hole course. The average monthly income for those lucky enough to have a job is $80. That compares with the $14,000 a month parliamentarians take home. Unless the politicians can help the poor, tribal war may one day be followed by class war.

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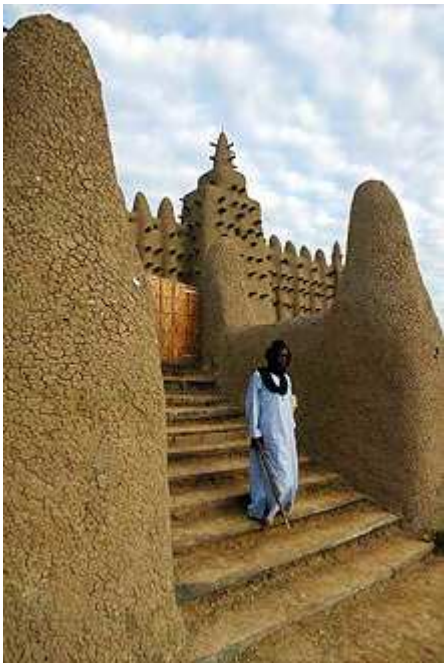
Mali

Mud, glorious mud

Mar 13th 2008 | DJENNÉ
From The Economist print edition

A remarkable legacy under threat

Reuters



Plasterers wanted...

“EVERY year the whole community works together to replaster the mosque,” explains Fané Yamoussa, a local Malian historian. “We start at sunrise after morning prayers and by lunch it's finished.” The dry months of January to March are the building season in Djenné, an ancient city in the Niger river's vast inland delta. Its Great Mosque is the world's largest mud building—and the reason for UNESCO naming the city as a world monument in 1988.

The minarets are 18 metres (59 feet) tall. The fortress-like walls are pierced with palm-wood beams. Every year in April, before the rains arrive, is the *crépissage*, when new mud is smeared over old walls. The city's chief replasterers, some 80-strong, belong to a centuries-old guild called the *barey ton*. As one puts it, “a good mason knows the building and the spirits.”

Work must start only on an auspicious day, determined by star-gazing and religious debate (and when the mud in the river is the right consistency). The foundations are blessed amid secret prayers, a mixture of Koranic verse and local magical incantation. Rituals mark each building phase.

Djenné is defined by its masonry. Built without plumb lines or spirit-levels, its houses have blunt edges, curvaceous parapets and leaning walls, giving the town a woozy feel. An early Muslim ruler, Koy Konboro, built the original mosque in 1300. It survived 530 often-turbulent years before it finally fell into wrack and ruin. The current edifice, a replica built on the same site, was completed just over a century ago. Its prayer hall, with its forest of 90 wooden pillars holding up the ceiling, can contain 3,000 worshippers. In recent years fluorescent strip lights have replaced the 104 cone-shaped skylights that once let shafts of ethereal sunbeams into the gloom.

But the mason's art is under threat. Young people prefer to make easier money as tourist guides or are leaving for the bustle of Bamako, Mali's burgeoning capital. “Children today don't want to be masons,” laments Mr Yamoussa. If the old knowledge is lost, his centuries-old mud city could disappear like a day-old sandcastle.

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The Franco-German relationship

The awkward partners

Mar 13th 2008 | BERLIN AND PARIS
From The Economist print edition

Illustration by Peter Schrank

France's Nicolas Sarkozy and Germany's Angela Merkel do not seem to get on. How much does this matter for Europe?

THE Franco-German relationship has been the motor of the European project. It is driven by an interlocking machinery of official meetings, consultations and diplomatic secondments. But it depends heavily on close links at the very top—between de Gaulle and Adenauer, Valéry Giscard d'Estaing and Helmut Schmidt, François Mitterrand and Helmut Kohl, Jacques Chirac and Gerhard Schröder. That makes the testy relationship between President Nicolas Sarkozy and Chancellor Angela Merkel a matter of concern far beyond France and Germany.

In German eyes, several French presidents have started badly. Mitterrand nationalised industries and banks in 1981. Jacques Chirac, his successor, began by testing nuclear weapons. By these standards, Mr Sarkozy has been mild. Yet he has not given Berlin an easy time. The impulsive president demanded political control of the euro, took credit for the release of Bulgarian nurses in Libya (and signed a nuclear-energy deal with the Libyans), insisted on postponing cuts in France's budget deficit and—the cause of the most recent row—pressed his project for a Mediterranean Union, a grand new club to bring together north African and European countries around the Mediterranean.

Ms Merkel has slapped down as many of these initiatives as she could. The two leaders have become famous for their squabbling. Ms Merkel even seems to dislike Mr Sarkozy's physical jauntiness towards her. His relationship to Germany in general, and to Ms Merkel in particular, is “difficult”, concluded the *Süddeutsche Zeitung* in February. This is a consequence partly of chemistry and partly of history. Ms Merkel and Mr Sarkozy have clashing styles of leadership as well as a different physical manner. The French president believes in acting before consulting. Ms Merkel, once a physicist, is an analytical sort who weighs arguments and gathers allies before coming to a decision. When Mr Sarkozy erupts, she has little choice but to contain him.

The Mediterranean Union is a prime example. The scheme has been assiduously promoted by Henri Guaino, Mr Sarkozy's Eurosceptic speech-writer (he voted against the Maastricht treaty in 1992). Ms Merkel, alarmed that Mr Sarkozy was trying to split the EU and divert resources into a body for Mediterranean countries alone, has forced him to retreat. At a recent meeting in Hanover, the two leaders agreed that the Mediterranean Union would be embedded in the EU's present structure, with all EU members welcome. This deal was due to be presented at this week's EU summit.

French thrusts followed by German parries seem to have become the norm. Germany has fended off French plans for a summit of euro countries and its push for a fundamental rethink of Europe's security and defence policy. Mr Sarkozy surprised his German partners by offering “strategic partnerships” with France to east European members of the EU and an “association agreement”, usually a prelude to EU membership, to Ukraine. “The Germans' number-one rule is no surprises, and Sarkozy keeps springing surprises,” notes Charles Grant of the Centre for European Reform, a London-based think-tank.

That does not mean the relationship can never work. After airing their differences, Ms Merkel and Mr Sarkozy sometimes narrow them. “The Mediterranean Union debate showed that France and Germany are able to compromise for the benefit of the whole EU,” says Andreas Schockenhoff, a Bundestag member from Ms Merkel's party. German optimists also praise Mr Sarkozy for helping to secure a treaty to replace the failed EU constitution, the main success of Ms Merkel's six-month EU presidency in early 2007.

The test of this cheery thesis will be France's own EU presidency, starting on July 1st. Mr Sarkozy has big plans for European defence, immigration, energy and agriculture. In Germany there is scepticism. “If you don't want to start everything and complete nothing you need to select where to put your energy,” says Daniela Schwarzer of Stiftung Wissenschaft und Politik, a Berlin think-tank. Some Germans doubt if Mr Sarkozy will achieve much beyond filling the top jobs created by the new treaty—and he may not even do that.

Yet even a productive French presidency could not rekindle the spirit of earlier Franco-German pairings. Mr Sarkozy and Ms Merkel have no joint project to match such earlier ones as the single currency. Even if they did, the EU's enlargement to 27 members makes it much harder for two countries to act as the only motor.

In Paris, there is less concern about the relationship. A Gaullist who is disrespectful of French diplomatic traditions, Mr Sarkozy has never cherished it as his predecessors did. He once called it “outdated”. As interior minister, he preferred working in a “group of five” with four other big EU countries. In his book, “Témoignage”, he wrote that “If the Franco-German understanding is still necessary, it is not a strong enough motor for Europe today. In my mind, that is self-evident.”

Once elected, and surrounded by old-school diplomats such as Jean-David Levitte, his diplomatic adviser, and Jean-Pierre Jouyet, his Europe minister, Mr Sarkozy at first fell into more traditional ways. He was careful to choose Berlin for his first foreign visit, flying there on the day he was inaugurated. He worked hard to promote the new EU treaty. Yet if there was initial admiration in Berlin for his energy, this turned to consternation when he claimed sole credit for the result. As one French diplomat says, “it's a rule of the Franco-German game that neither side should win.”

Since then, Mr Sarkozy seems to have lurched from lingering scepticism about the importance of the relationship into outright disregard. His abrasive, unilateral diplomacy mirrors the methods he uses at home. But it is one thing to use such tactics when dealing with striking rail workers or protesting students. It is quite another to apply them to diplomatic friends.

The low point so far has been over the Mediterranean Union. Yet Mr Sarkozy's team were initially unbothered by German concerns. “The Mediterranean Union plan was sold in the most catastrophic and aggressive manner by the French government,” says Dominique Moïsi, a French commentator. “Nicolas Sarkozy did not realise to what extent an excellent relationship with Berlin was the key to all his efforts.” It took a plea by members of Mr Sarkozy's own government, aware of German exasperation, to get the message to the Elysée. France's EU presidency, they argued, could be wrecked by falling out with the Germans over the project.

For now, the tension has been eased. French diplomats argue that Mr Sarkozy has recognised the limits of his unilateral approach, and come round to the reality of the need to square Germany first. But they see this less as a conversion on principle than a pragmatic reassessment, because Mr Sarkozy did not want to spoil his six months in the sun. There will be plenty more issues, ranging from European defence to industrial and exchange-rate policy, in which French and German interests will diverge. Given Germany's shaky trust in Mr Sarkozy, it may take heroic efforts to resolve them.

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Ireland's prime minister

Ahern at bay

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Another economy suffering from a property bust

SPAIN is not the only country in Europe to be feeling the after-effects of a burst property bubble (see article). Another may well be Britain; and a third, even more spectacularly, is Ireland. In the Irish case, the prime minister, Bertie Ahern, is suffering as well.

Indeed, when Mr Ahern meets George Bush next week for the annual St Patrick's Day bash in the White House, it may be the last such party for both men. Mr Bush will be gone by next year. And Mr Ahern, who was returned only last May to a third term as head of a three-party coalition, is struggling to stay in power. A Teflon taoiseach (prime minister) for most of the past 11 years, Mr Ahern has lost his non-stick coating.

His immediate problem stems from a tribunal investigating corrupt payments to politicians. Mr Ahern's explanations for loans and gifts he received when finance minister in the 1990s have not satisfied a sceptical public. His evasiveness under cross-examination has damaged his credibility and depressed his poll ratings. Half the electorate, says one recent poll, do not believe him; and half no longer trust him to run the country.

Mr Ahern insists he will not resign, having vowed to serve a full five-year term. But he has other problems, the biggest being the economy. A strong euro, slowing exports to America and Britain, and the property bust have all depressed growth. The credit crunch has squeezed lending, house prices are tumbling and building activity is in sharp decline. The challenge for the government is to manage the transition from high to low growth, without damaging confidence and the public finances. Talks between employers and unions on a national pay deal are expected to conclude next month. These may decide how smooth the adjustment will be.

Mr Ahern's other concern is to win the referendum on the Lisbon treaty that is likely to be held on June 12th. Ireland is the only EU member planning to put the treaty to a vote. The polls show a two-to-one margin in favour. But in 2001 Irish voters narrowly rejected the Nice treaty first time round even though polls showed strong support in advance.

Mr Ahern is taking no chances. He may choose to adopt a low profile in the campaign, to stop it turning into a referendum on him. Success, he knows, would make him a more serious contender for a new post, being created by the Lisbon treaty, of full-time president of the European Council. Such a job might just offer Mr Ahern a neatly timed exit from Irish politics.

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Spain's election

Back—to a new challenge

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The re-elected Socialist government faces tough economic problems

AP

No time for Zapatero to sleep

AT FIRST sight, the election in Spain on March 9th changed little. José Luis Rodríguez Zapatero led his Socialists to a slightly bigger win than in March 2004. His party has a 16-seat lead over its main opponent, the centre-right People's Party (PP), in the 350-seat parliament—the same as before. Mr Zapatero will be prime minister for another four years. The PP leader, Mariano Rajoy, has lost two elections running and yet he plans to stay on. Neither proposes big changes to party policy. Is Spain due to repeat the past four years?

The answer is no. Mr Zapatero's re-election comes in different circumstances. His 2004 victory was linked to the Islamist train bombings that had rocked Madrid three days earlier, killing 191 people. It was a vote of no-confidence in an outgoing PP government that tried to blame the massacre on the Basque separatists, ETA.

This time ETA did carry out an attack before the election. A former Socialist councillor in the Basque town of Mondragón, Isaías Carrasco, was shot as he left for work. His wife and daughter found him bleeding to death on the ground. The killing may have pushed more voters into the polling booths, but it does not explain Mr Zapatero's victory. Spaniards simply decided that he was the best man to take them through difficult economic times.

Mr Rajoy led his party to defeat but raised its share of the vote and its number of deputies. He plans to stand for re-election as party leader in June. A victory would allow him to sack unpopular members of the team inherited from his predecessor, José María Aznar. He will not, however, change his party's policies. “If I change the message, I'll change party,” he promised after daring other party heavyweights to challenge him.

Spain's regional, separatist and far-left parties all suffered in the election. In all, they lost a quarter of their support, with the most left-wing and separatist parties doing worst. That let both the Socialists and the PP pick up a handful of new seats. Yet Mr Zapatero is still seven seats short of an absolute majority and must seek the support of other parties.

He has two regional options: the Basque Nationalist Party or Catalonia's Convergence and Union (CiU). Otherwise he may opt for smaller parties based around two supporters in the previous parliament, United Left and the separatist Catalan Republican Left (ERC). These two parties lost eight of their 13 seats. A long-term pact may not be needed: previously, Mr Zapatero negotiated support for each measure presented to parliament, including annual budgets. He could do so again.

The biggest change over the next four years will be in the issues politicians argue over. Spain's long economic boom faltered in the run-up to the election. Structural reforms to deal with the weaknesses of an economy heavily dependent on a building boom and cheap immigrant labour were not made. Spain's bitterly divisive internal politics, based on partisan rows over devolving power to the regions, dealing with ETA, funding the Catholic church or introducing social reforms, have dominated all debate. Mr Zapatero's negotiations with ETA failed. He is unlikely to try again. He gave Catalonia a new charter, parts of which might yet be struck down by the constitutional court. But unless his putative CiU allies demand even more, the matter is settled for now.

The real concern is the economy. Inflation is running at 4.3%. Growth is predicted to drop from 3.5% to

2.4% or less this year. It may well fall again in 2009. Several property and construction companies are in trouble as the housing market grinds to a halt. Some 60% of bank loans are property-related. Unemployment is rising fast. The finance minister, Pedro Solbes, who will stay in his job, hopes that a €400 ($620) annual income-tax rebate will be approved soon. Increased public spending on infrastructure projects is also likely.

Decisions on the economy will depend on where Mr Zapatero turns for support. Some parties, like CiU, favour liberal measures such as cuts in corporate tax. United Left and the ERC do not. “The biggest challenge for the economy is to increase productivity,” says Mr Solbes. It is time, in short, to get serious about reform.

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Italy's election

Bridges and other promises

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Sicily will once again play a big role in the Italian election

A MAN of much wealth and many words, Silvio Berlusconi is trying hard to lure Sicily's 4m voters to his right-wing party. His hopes of regaining power in the Italian election on April 13th-14th depend on winning big on the island, where his coalition made a clean sweep of first-past-the-post seats in 2001 (the balance shifted in 2006).

The Union of Centre and Christian Democrats (UDC), a former ally of Mr Berlusconi that is strong in Sicily, is running independently of his coalition. The radical left is also running separately from the centre-left Democratic Party, led by Walter Veltroni. These decisions, along with a baffling voting system, could leave Mr Berlusconi vulnerable in the upper-house Senate even if he wins the lower-house Chamber of Deputies. Romano Prodi's centre-left government fell when it lost its Senate majority.

The arithmetic explains Mr Berlusconi's efforts to woo Sicilian voters. His promises include laws to boost tourism and the food industry, a strategic plan to clean up the chemicals industry, special tax breaks, a new bank for the south, the creation of free ports and a ten-year infrastructure plan. He is also committed to building a bridge over the Messina strait. This bridge, which was jettisoned by Mr Prodi's government because its benefits do not justify the huge cost, is also backed by the UDC.

After Mr Prodi's government decided against the bridge, Luigi Croce, Messina's chief prosecutor, declared that “the bridge would be a way for *Cosa Nostra* in Sicily and the *'Ndrangheta* in Calabria to get rich.” A report by the national anti-Mafia authority in 2001 had already opined that the business a bridge would bring the Mafia could “easily be imagined”. That makes Mr Berlusconi's promise to tackle organised crime welcome.

Even so, among his party's candidates for the Senate is Marcello Dell'Utri, sentenced in 2004 to nine years' imprisonment for complicity with the Mafia. Mr Dell'Utri, a longstanding associate of Mr Berlusconi, is appealing against the conviction. He is not the only candidate to have had trouble with the law. Salvatore Cuffaro, a former president of Sicily's regional government, was sentenced to five years in January for aiding and abetting *mafiosi* (he is appealing). Yet he heads the UDC list for the Senate in Sicily.

The quality of candidates matters little, as voters choose among party lists. So what will sway them? If advertising counts then Mr Berlusconi, whose posters dominate Palermo, will win. Some voters even believe election promises. If Mr Berlusconi wins, he may push ahead quickly with the bridge. “It would be a permanent memorial to his period in power,” says Pietro Busetta, head of Fondazione Curella, a Palermo think-tank.

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Serbia's politics

Election time

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The government quits, paving the way for an early election

AP

Kostunica, contemplating uncertainty

AS PREDICTED, Serbia's government has collapsed. A general election is to be held on May 11th. The big issues before it, says Vojislav Kostunica, the outgoing prime minister, will be Europe and the future of Kosovo. He argues that Serbia should continue on the path of European integration only if the EU accepts that Kosovo is part of Serbia. President Boris Tadic retorts that only by keeping on track towards Europe can Serbia actively undermine Kosovo's attempts to win full acceptance as an independent country.

Kosovo has a population of some 2m, 90% of whom are ethnic Albanians. On February 17th it declared independence and was promptly recognised by America and most European countries. The EU is sending a big mission to help run the new country. But the independence of its former province has been denounced as illegal by Serbia and its ally, Russia.

Serbia held a general election a year ago and a presidential election last month. Because of this political turmoil, foreign investment is beginning to dry up. In effect, Serbia is losing time. For years the largest party has been the Radicals, whose founder is on trial in The Hague for war crimes. It is quite possible that, after the election, it will enter government for the first time since 2000, in coalition with Mr Kostunica.

In the past such a prospect would have led to panic among EU leaders. But now the mood is changing. Meeting to discuss the situation in Brussels this week, a number of ministers and senior officials shrugged on news of the election. Olli Rehn, the enlargement commissioner, says that, in the polls, “Serbia will either turn to its European future or risk self-imposed isolation.” Ask people in Brussels if there is a Plan B should Serbia opt for what Mr Rehn calls the “road to nowhere” and it seems as if the answer is no.

But dig deeper and officials are talking of “contingency planning”. What this means in practice is extra help for Montenegro, Macedonia, Bosnia and Albania, in case Serbia opts out of the EU. EU assistance to people in the western Balkans is already the highest per head in the world. All sorts of programmes, many dull but worthy, are being developed.

Recently a Serbian envoy told his Western colleagues that the best way to help pro-European Serbs was to make sure that the rest of the region made no progress towards Brussels so long as Serbia's bid was stalled. He was told that if he expected the EU to do that, he needed to take a check on the realities of the world. Dimitrij Rupelj, foreign minister of Slovenia, holder of the current EU presidency, knows more than most how much has been done to help Serbia and its democrats in the past few years. Now he says that “if there is no agreement with our Serbian friends, the train will move on and they will be left lagging ever further behind.”

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Poland's economy

Work in progress

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The Polish government has a long way to go to get the economy in shape

HIGH hopes, fine words and modest results. That is the story so far of Poland's newish centre-right government, in office since November, as it tries to sort out the country's deep-rooted economic problems in the face of a global slowdown. The previous government, an oddball coalition, frittered away the chances offered by rapid GDP growth (6.5% in 2007) to restructure public finances. Although strong growth in investment and consumption means that the economy is still looking good, competitiveness is suffering as wages grow faster than productivity and the currency appreciates.

The British-born finance minister, Jacek Rostowski, has ambitious-sounding plans to cut the budget deficit until it reaches 1% of GDP in 2011, thus shrinking public debt and preparing for possible entry into the euro area in 2012. But he needs convincing details to match his bold aims. At least Poland is now explicitly aiming to join the euro; the previous government's approach was “wait and see”. Personal income tax will be lower and flatter next year; other taxes will come down too. An economist who follows Poland closely says that the policy goals are “well thought out”, but adds that most reforms are still plans, often vague ones, not reality.

The urgent need is to raise productivity by liberalising the labour market, privatising state-owned enterprises and cutting red tape. Poland's bureaucracy has won a shaming 74th place in a World Bank ranking, behind even Bulgaria and Romania, the EU's newest and poorest members. A parliamentary committee is to examine superfluous regulation. Though little has changed so far, Henryka Bochniarz, head of the private employers' body, praises the government's “real determination” .

The prime minister, Donald Tusk, seems to lack grit. He has caved in to demands for higher wages by border guards and doctors; now the nurses are clamorous. The numbers of public employees able to retire in their 50s have only been shaved. Poland's labour-force participation rate is dire, at around 54%, ten points below the EU average. The government has pledged to boost legal employment by making it easier to set up a business. But it is still far easier in Britain, notes a Polish-based British businessman.

The government flinches at unpopular spending cuts, reflecting feelings in a reform-weary population. The president, Lech Kaczynski, is the twin brother of the former prime minister. He has an eye on re-election in 2010 and he wields a veto over new laws. Without costly deals with the opposition, Mr Tusk lacks the parliamentary majority to overrule him.

Bad relations between prime minister and president have spilled into a row about the central bank, one of the few public institutions trusted by most Poles. The bank's governor is an old friend of Mr Kaczynski's who supports the previous government's doveish monetary policy. That has alarmed inflation hawks (including the former governor) and caused conflict with the bank committee that sets interest rates. In January both deputy governors resigned. One, Krzysztof Rybinski, says that the dispute-ridden atmosphere at the bank has been “demotivating” for all the staff. Mr Tusk has so far refused to approve one of the governor's nominees as deputy. As inflation accelerates past 4%, the uncertainty matters. Higher prices mean higher public-sector wages, further undermining the planned fiscal tightening.

The new Polish government's heart may be in the right place. But it will need more than that if it is to put new Europe's largest economy on track.

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Charlemagne

The parable of the presidents

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Illustration by Peter Schrank

The Lisbon treaty leaves Europe with a plethora of presidents

KING SOLOMON, relates the Bible, acted wisely and decisively when faced with two women claiming the same baby: his threat to cut it in half swiftly revealed the real mother. The European Union is different. Faced with two rival plans, its approach is to say yes to both, delay a reckoning for years and then throw money at the compromise. If EU leaders were running Solomon's court they would award both women custody, build parallel nurseries with public funds and review progress in 2014.

As a strategy, this has a big flaw: it does not work. Just ask EU diplomats and politicians as they ponder dozens of questions left unanswered by the Lisbon treaty that their bosses signed last year and pledged to ratify by the end of 2008. Some potential clashes have been obvious for a long time. Thus, two new figures created by the treaty have been promised overlapping jobs speaking for Europe: a new foreign minister (called the “high representative” for foreign and security policy, to avoid scaring the British); and a full-time president of the European Council, to be chosen by the 27 national leaders to chair their summits and speak for them inside the EU machine.

More recently, governments have woken up to another fudge, described by several officials as “the real problem” with Lisbon, “the really delicate question” or simply “a mess”. It too concerns the two new posts, but this time how exactly they relate to the rotating six-month presidency. This is the system under which each EU country takes its turn in charge: its transport minister chairs EU transport councils for half a year, its environment minister chairs environment councils and so on (Slovenia has the job at the moment).

The presidency offers a country a mix of drudgery and real clout. Its foreign minister chairs the powerful general affairs and external relations council or GAERC (elegantly known as the Gurk), which prepares summits as well as policies on such matters as Iran and Kosovo. Its head of government gets to chair EU summits in Brussels and be seen on television hobnobbing with the American and Russian presidents. At best, this gives each country a stake in the system, and an interest in playing by the rules (because every now and then it gets to be referee). Rotating presidents may also emerge sadder and wiser from their stints, because they learn about the selfish, furtive national interests that often block EU policies for years. At worst, however, the system lacks coherence and even dignity (seasoned observers still shudder when they recall Silvio Berlusconi's stint in 2003).

Such horrors led France and Britain, when the constitutional treaty (Lisbon's precursor) was being drafted, to push for the rotating presidency to be abolished and replaced by the creation of a full-time

president. Other ministerial councils, it was proposed, would either be chaired by a brighter-than-usual national minister, elected by his peers, or divvied up among three or four countries clumped together in a “team presidency”. But smaller EU members correctly feared that they were being trampled on, and mounted furious resistance.

There followed what one official calls a “cynical stitch-up”. Germany backed a full-time president in return for getting agreement to an EU foreign minister who (despite French and British qualms) will represent national governments and also serve as a member of the European Commission. However, the smaller countries also won a deal to retain the rotating six-month presidency. And the text describing the full-time president's mandate was pared down into gibberish. As a result, his or her role remains unclear: a globe-striding “Mr Europe”, a low-profile broker of Brussels deals, or merely a ceremonial figure (German officials talk of their president as one possible model).

The role needs to be defined in time for the first president to take office on January 1st next year, assuming Lisbon is ratified on schedule. But it is now trapped in a closed loop of EU logic. The nature of the job will determine who applies (Tony Blair, for example, might not fancy a post that amounts to putting out chairs at Brussels summits). Yet the identity of the first president will also help to determine what the job is.

The revenge of the giants

The victory of the tiddlers is also looking hollow. True, rotating presidencies will retain as much as 90% of their present duties. But they will lose the best 10%. The GAERC is to split, creating a foreign-affairs council (“the FAC”), chaired by the high representative, who will lead on foreign policy and defence, and may end up overseeing discussions on trade and development as well. The foreign minister of the rotating presidency will be left with a general-affairs council (“the GAC”), but the treaty is vague on exactly what this will do.

Astonishingly, says one official, it is also only just sinking in that, although rank-and-file ministers will still chair specialist EU councils, heads of government have been left with no role at all. This matters: political leaders of countries holding the rotating presidency will have little incentive to invest their energies in the project if their underlings get all the glory (an especially sore point in coalition governments).

If the treaty is ratified by December, the first countries to hold this headless rotating presidency will be the Czech Republic and Sweden. The Czechs are “very upset”, it is reported. Visiting the European Parliament, the Swedish prime minister, Fredrik Reinfeldt, pointedly said that government leaders needed “a clear role” during their presidencies, floating the idea of “a co-chair situation” with the new full-time president.

This is not going to happen. Brussels types instead talk of possible sops: letting the prime minister of the rotating presidency speak first at summits, or host the odd informal summit at home, or sit on the podium at summit press conferences. The EU has only a few months to sort this out. King Solomon would know what to do. Unless he was a European.

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Public finances

Boxed in, fingers crossed

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AFP

The budget is implausibly optimistic about the economic and fiscal prospects

IF ALISTAIR DARLING has had a difficult time since taking on Gordon Brown's old job last June, he has himself, in part, to blame. The chancellor of the exchequer dithered for months over what to do about Northern Rock before eventually nationalising the failed mortgage lender in February. He needlessly alienated businesses and rich foreigners with ill-considered tax reforms in his pre-budget report last October and after.

After such a torrid start, Mr Darling's first budget was a vital opportunity for him to regain lost ground. But it mattered just as much to his boss. Mr Brown became prime minister because his success as chancellor had helped Labour secure three successive election victories. The shakier his government's economic and fiscal credentials begin to look, the less likely a fourth term becomes.

One of Mr Darling's main objectives was to try to undo some of the damage from last autumn's botched tax reforms. In January the chancellor had already made a big concession to entrepreneurs furious about his shake-up of capital-gains tax. Not long afterwards the Treasury backed away from a threatened crackdown on offshore wealth held by rich foreigners who claim “non-domiciled” status.

Mr Darling used the budget to confirm that non-doms who have been in the country for more than seven years will pay a £30,000 ($60,000) annual charge from April if they wish to retain their status, which shields their overseas earnings and capital gains from tax unless they are remitted to Britain. But he also offered an assurance to non-doms, who have been unsettled by the reform and feared more might follow. He promised “no further changes to this regime for the rest of this parliament or the next”.

The new measures in Mr Darling's budget in fact amount to little. The chancellor increased spending designed to curb child poverty. He raised taxes on alcohol and on vehicles, ostensibly for environmental reasons (see article). The net effect of all his measures was very limited: a loss to the exchequer of £140m in 2008-09, a yield of £790m in 2009-10 and of £1.9 billion the following year.

The heart of the budget thus lay in the outlook that Mr Darling presented for the economy and the public finances. Ominously for the chancellor, it is not just rich foreigners who are fed up and anxious. The general public is now rattled about the economy, after a long period in which it was down the list of people's worries. Recent opinion polls by Ipsos MORI have shown a depth of gloom surpassed only once in the past decade.

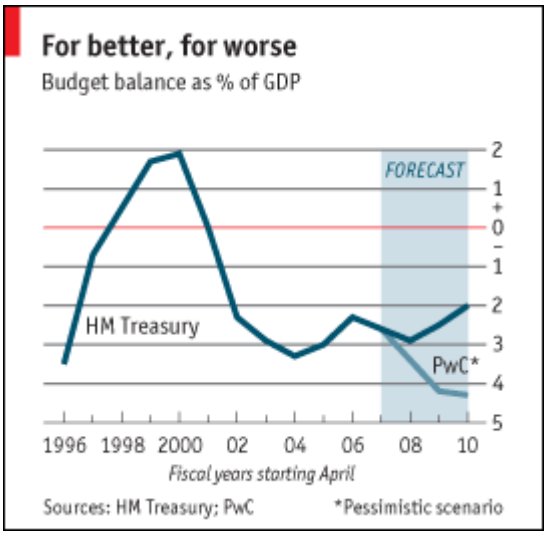
Just as the non-doms received reassurance, so too did the public through Mr Darling's emollient economic forecasts. The chancellor concedes that the economy will decelerate after the hectic growth of the past two years, when GDP expanded at an annual rate of 3%. He thinks, however, that the slowdown will be fairly mild. In October he had already lowered his forecast for GDP growth in 2008 from a midpoint of 2.75% to 2.25%, while leaving the projection of 2.75% in 2009 unchanged. The forecasts have now come down to 2.0% and 2.5% respectively.

Unfortunately, Mr Darling's new guess at next year's growth looks unduly optimistic. *The Economist*'s panel of forecasters expects the economy to grow by 1.9% this year and by 2.0% in 2009. Those predictions could themselves be too sanguine as America's mortgage woes continue to infect global credit markets; there is a sizeable risk that Britain could suffer a severe downturn. John Hawksworth, an economist at PricewaterhouseCoopers, an accountancy firm, is close to the consensus in his central forecasts for economic growth over the next two years. But he thinks there is a 20-25% probability of a more pessimistic scenario: the economy might grow by about 1% this year and by 0.5% in 2009.

Mr Darling's fiscal forecasts were somewhat less soothing than his economic ones. He is now planning to borrow £43 billion in 2008-09 rather than the £36 billion he predicted in the pre-budget report in October. The deterioration carries through to 2009-10, when the Treasury expects to borrow £38 billion instead of October's estimated £31 billion.

The chancellor's fiscal sums have been thrown awry by Britain's own property problems and a sharp decline in the stockmarket since the autumn. Together, these will reduce revenues by £3.5 billion in 2008-09 from the pre-budget estimates. The chancellor has also had to lower his projections for VAT revenue in the same year by £2 billion because of slower than expected growth in consumer spending.

Mr Darling may have acknowledged a deterioration in the public finances, but things could easily get much worse. If the economy turns really sour, public borrowing could increase tremendously. If Mr Hawksworth's pessimistic growth scenario materialises, borrowing would rise to over 4% of GDP in 2009-10 rather than coming down to 2.5% as the chancellor is hoping (see chart). That would entail public borrowing of £63 billion rather than £38 billion.



“Once again the Treasury is hoping for the best—an increase in borrowing that will prove temporary,” says Robert Chote, director of the Institute for Fiscal Studies, a think-tank. The chancellor was forced, in effect, to cross his fingers because the public finances are already in such a mess. It is extraordinary that the government should be running such a big deficit this year after so long a spell of growth. This has ruled out a fiscal boost to support the economy and left the public finances extremely vulnerable to an economic setback.

Mr Darling may be too complacent but he is boxed in by his inheritance. If the chancellor is now in a fiscal fix, it is because his predecessor overspent and over-borrowed, and for far too long. Mr Brown had every chance to put the public finances on a sounder footing. If they go badly awry now, his government will pay a heavy political penalty.

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Environmental taxes

Hot air

Mar 13th 2008
From The Economist print edition

The revolution that wasn't

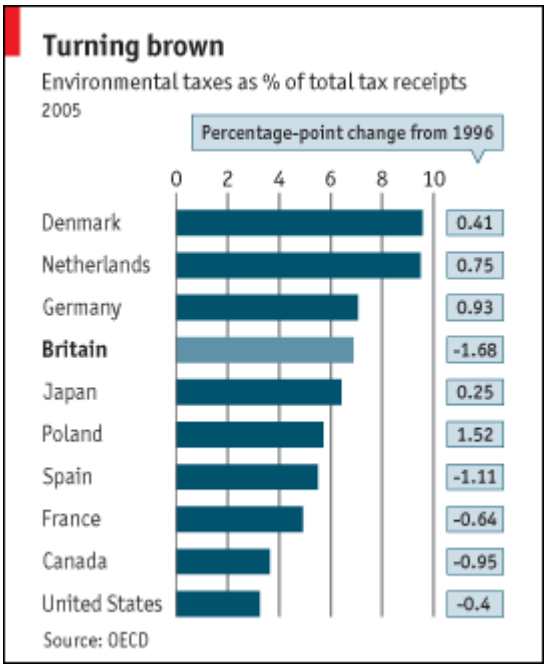
FORECASTING is a dangerous business, especially where money is concerned. As long ago as December, Alistair Darling, the chancellor, had been promising that sustainability would be “at the heart of the next budget”. As the big day approached, green promises multiplied. On March 10th the *Guardian*, a paper with close contacts in government, said that the budget would be Labour's “greenest budget yet”.

But after the dust had settled, environmentalists were left scratching their heads. Mr Darling hardly mentioned climate change until near the end of his speech. Many of his announcements were reheated (such as bringing aviation into Europe's emissions-trading scheme), modest (the climate-change levy, an industrial tax, will rise with inflation) or so speculative as to be irrelevant (a suggestion that the target for carbon cuts might be raised to 80% by 2050 from 60%). A headline-grabbing plan to charge for plastic bags has, whatever its other merits, almost nothing to do with climate change.

The world-weary argue that greenery was merely a convenient cloak beneath which a cash-strapped government could levy a few more taxes. Take car-tax reforms, the most substantial of Mr Darling's pronouncements. These are designed to tax dirty vehicles more heavily through a combination of annual levies and a one-off purchase tax. Frank Sangster, head of environmental tax at KPMG, a consultancy, points out that, in contrast to many of its other measures, the government refuses to say how much carbon it expects the reforms to save. But it does predict that they will raise £735m ($1.5 billion) a year by 2010, more than any other budget policy.

In Mr Darling's defence, he is in a bind. Much of his speech concerned the impact of high inflation, driven partly by big rises in oil prices. Environmental taxes are in effect taxes on energy use—difficult to sell amid worries about rising inflation and fuel bills. And tax is not the only way to encourage greenery.

The risk is that rhetoric will become still more divorced from reality. Environmental taxes have fallen as a percentage of total tax receipts since Labour came to power (see chart), despite Mr Darling's claim that “our greatest obligation to future generations must be to tackle climate change.” This budget won't reverse that fall, says Paul Ekins, an economist at King's College, London. Nor will it put much of a dent in Britain's carbon emissions—which, despite plenty of warm words, have hardly budged since 2002.



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Shake-up at M&S

A Rose by any other name

Mar 13th 2008
From The Economist print edition

A retailing star ticks off investors at an awkward time

AN ICONIC retailer is ruled by a brilliant yet absolutist boss who, contemptuous of corporate-governance precepts, becomes chairman and chief executive. Although he leads the firm to greatness, he is felled by hubris. Shareholders lose confidence. Hostile bidders circle. The firm eventually dusts off the rulebook and splits the roles of chairman and chief executive to win back institutional investors.

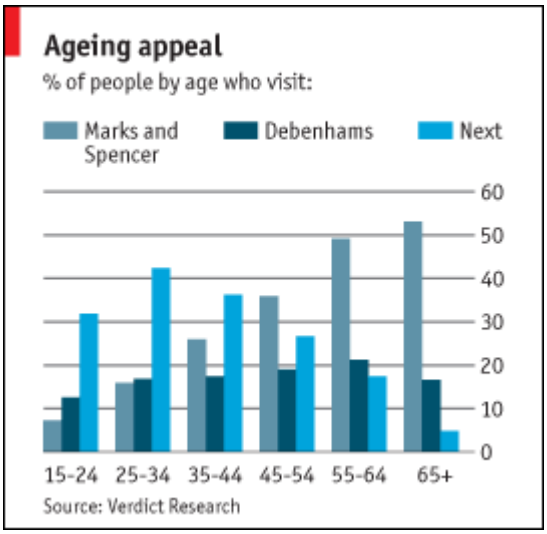
Such was the history of Marks & Spencer, Britain's biggest clothing retailer, eight years ago. Is the cycle now turning with the announcement on March 10th that the firm's gifted chief executive, the newly ennobled Sir Stuart Rose, is taking on the role of executive chairman too? M&S board members say they had to agree in order to keep him around beyond 2009, when his existing contract runs out. Sir Stuart is credited with engineering the dramatic improvement in the retailer's performance from 2004, and with tougher times looming his fans were loth to let him go.

Investors, however, are furious. Legal & General, an insurer, frets that his promotion is a “potentially damaging concentration of power”. The Association of British Insurers, which represents many large investors, has demanded an explanation.

Shareholder unease comes at an awkward time for the firm. After nine quarters of steadily improving sales, M&S stumbled over Christmas. In January it said that in the last quarter of 2007 sales in stores that had been in existence for at least 12 months slumped by 2.2% from a year earlier, and clothing sales by 3.2%. Same-store sales at rivals rose, however, and retail sales in general were 3.7% higher in December. M&S shares have fallen by 31% this year, compared with 20% for the retailing sector.

It seems unlikely that this was just a blip. M&S misread the market. It put more cheap clothes in its stores over Christmas when rivals such as Debenhams and Next did well with dearer ones. And the mistake underlined a deeper problem: whether the firm should try to appeal to rich and poor, sensible and fashionable, young and old, in a market that is fast polarising between shops specialising in either cheap or opulent, either young or old.

M&S is most popular among the over-65s (see chart) but it has had some success of late in attracting younger shoppers. Yet it tripped up in trying to sell clothes for a song alongside more expensive ones, in attempting to be all things to all people. Just as the fate of great nations can turn on otherwise inconsequential events—a sudden squall that scattered the Spanish Armada, for example—M&S's destiny may ultimately rest on the reputation of its underpants. These became a hot topic in January after a letter from Jeremy Paxman, a verbally pugilistic television interviewer, to Sir Stuart was made public. M&S underpants, he said, no longer provide “adequate support”.



Newspaper columnists fulminated. Letters pages were deluged with similar complaints, and Mr Paxman said he had heard from lords and top lawyers on the matter. And this was not mere puerile fascination. A third of women and a fifth of men buy their underclothes at M&S. His complaint struck a chord with loyal customers, many of whom suspect that quality is slipping.

That may be an unintended consequence of Sir Stuart's attempts to draw in price-conscious shoppers. Analysts at Deutsche Bank reckon that M&S devotes almost a third of its space to cut-price clothing these

days, up from 12% in 2003. Many people coming through its doors now see and buy only the cheap stuff. Concentrating on the bottom end of the market also puts the firm into direct competition with supermarkets such as Tesco, which are hard to beat on price and are steadily increasing their share of the clothing market.

M&S is doing best where it has focused on a narrow section of the market. In food, where it accounts for just 4% of all sales, M&S is known for expensive and healthy produce and meals. Its sales are holding up, and may continue to do so: Joanne Denney-Finch of IGD, a grocery think-tank, says that in previous downturns consumers ate less in restaurants and spent more on the sort of ready meals that M&S makes. In clothing, however, where it has 11% of the market, the firm seems destined to keep battling for the middle ground.

Resolving this impasse is no easy task, and Sir Stuart may well be the best man to do it. That the outlook is getting bleaker may explain why he has flouted investors' preference for separating the top jobs. Yet the firm deserves good governance, and Sir Stuart needs all the help he can get.

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Adam Smith

Monumental profits

Mar 13th 2008 | EDINBURGH
From The Economist print edition

The economist's house is on the (free) market

IN MOST countries it would have been marked by a fanfare of press releases and a long roll of fund-raising drums. Not in Scotland. This week Edinburgh's city council put on the market the house where Adam Smith spent his last 12 years, from 1778 until 1790. Advertisements in the property sections of local newspapers seek offers in excess of £700,000 ($1.4m) for a 17th-century house of historical interest, but fail to point out its connection with the father of modern economics.

This indifference to one of Scotland's greatest sons in the city where he spent much of his adult life is curious, but consistent. His house, recently a municipal centre for troubled boys, has a small, tarnished bronze plaque recording it as the town house of the Earls of Panmure and the home of Adam Smith. His grave just off the High Street was overgrown until 2006 when, thanks to £10,000 from an expatriate Scottish oilman, it was cleaned; visitors still have to hunt for it. In Glasgow, where Smith lectured for more than a decade, a professorship is named after him but there are no other signs of his tenure.

This disregard stems more from modern Scottish politics than from historical ignorance. Smith's most famous work, “The Wealth of Nations”, which describes wealth creation in a competitive commercial economy dominated by the market's invisible hand, has long been appropriated by right-wingers and anathema in left-leaning Scotland.

But a daring bid to claim Smith for the left is under way, led by Gordon Brown. The Labour prime minister's constituency includes Kirkcaldy, where the economist's birthplace and school are now marked with commemorative plaques. The town also hosts an annual Adam Smith lecture, given in recent years, thanks to Mr Brown's connections, by such luminaries as Mervyn King, governor of the Bank of England, and Alan Greenspan, former chairman of America's Federal Reserve Bank.

Leftists much prefer Smith's other big work, “The Theory of Moral Sentiments”. Its deeply Scottish Presbyterian fulminations against materialistic desires for “trinkets of frivolous utility”, and lofty observation that man has some principles “which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it”, can be made to sound almost socialist. This turn in fashion seems to have persuaded Edinburgh's council, then run by Labour, to approve in 2004 a plan by the Adam Smith Institute, a think-tank in London, to erect a statue of the great man. It will go up soon in the High Street.

And the house, which fans of Smith had wanted preserved as a museum or a study centre? It has, say the estate agents, “development potential”—which means there is probably private-sector profit to be made from converting it into flats or offices, for example. Which Adam Smith would certainly have thought a more fitting memorial than getting taxpayers to underwrite a shrine.

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Assisted reproduction

A chip off the old block, please

Mar 13th 2008
From The Economist print edition

Choosing children is not a straightforward business

HOW much right do parents have to shape their children? Except in cases of downright neglect, we generally allow them a pretty free hand. The religious, the musical and the sporty all push their offspring down certain paths and—even if just by spending time that could have been used for other pursuits—close off others.

But new reproductive technologies allow parents to choose their children, rather than merely make choices on their behalf. Take Londoners Tomato Lichy and Paula Garfield, who are both profoundly deaf, as is their daughter Molly. They would like another child and, as Ms Garfield is over 40, are considering in vitro fertilisation (IVF) in order to have one. They want that child to be deaf too. That way the new arrival would fit into the family and share in deaf culture, speaking sign language as a mother tongue.

In principle at least, if the couple do choose IVF they could peek at the possibilities before choosing which child to bear. In “pre-implantation genetic diagnosis” (PGD), doctors take a cell or two from each of the embryos produced in vitro. They check which ones carry particular genes of interest before selecting embryos to put in the mother's womb. If the genes that cause the couple's deafness can be identified, PGD could grant them the child they want.

But not in Britain. The law governing fertility treatment is now being updated in a bill before Parliament, and using PGD to pick embryos with faulty genes in preference to those without them is to become illegal. Since deafness is generally considered a defect—a proposition the couple lambast as discriminatory “audism”—Mr Lichy and Ms Garfield would have to take their chances with normal conception or IVF, or else screen and discard the very embryos they prefer.

The case is something of a thought experiment. At the moment PGD is permitted in Britain only to screen out embryos carrying genes that cause serious, life-limiting diseases, such as Huntington's chorea and cystic fibrosis.

But deaf would-be parents who want to have deaf children are a favourite “what if” of medical ethics, and the government wants to future-proof its legislation in this fast-moving field. As the genes underpinning various conditions are better understood, the scope for prospective parents to tailor their offspring to their liking will expand. Ministers are determined to close the door on choices they deem damaging to the new child.

The bill presents parliamentarians with other ethical conundrums too. Traditionalists are unhappy that references to IVF babies' “need for a father” are to go, and that lesbian couples will be able to be named jointly on the birth certificate of a child whom one partner has conceived by donor insemination. And the legalising of stem-cell research using “chimera” embryos, produced by placing human genetic material inside hollowed-out, unfertilised cow or rabbit eggs, may lead to full-scale rebellion. Three Catholic government ministers could even end up choosing between their jobs and their consciences. Ministers normally step down if they vote against government-sponsored legislation—and research that manipulates or destroys embryos was included in a list of seven new “deadly sins” published by the Vatican on March 10th.

Alongside these new ethical controversies, an old one will also receive an airing. One of the amendments to be debated would make it harder to get an abortion after 20 weeks' gestation, rather than 24, as now. Questions about parents' “right to choose” only multiply.

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Vanishing children

Missing, presumed married

Mar 13th 2008
From The Economist print edition

Pakistani girls and Chinese whispers

IT IS hard to believe that one of the responsibilities of Britain's mighty Foreign Office is to rescue its own citizens from forced marriages in other lands. But it is—and the job is getting bigger. Last year the Forced Marriage Unit, an operation run jointly by the Home and Foreign Offices, dealt with some 400 cases, up by a third on previous years. Nearly half required investigation overseas. Each year its officers repatriate up to 75 British victims and free many more at home.

There are more still, of course, who are not rescued. Forced marriage, like all domestic abuse, is badly under-reported because victims are reluctant to shop their families, who are usually complicit. The profile of the victims—90% Pakistani or Bangladeshi, and mainly poor—makes them especially unlikely to be in contact with the state services that could help.

Ongoing efforts by a committee of MPs to get a grip on the problem show how slippery it is. On March 4th Kevin Brennan, the minister for children, told the parliamentary Home Affairs Committee that in Bradford, a northern city with a large Asian population, 33 children had gone missing from school rolls. Inferring that these unfortunates had been whisked away to unholy matrimony, the MPs asked to see the school records for 13 other areas where forced marriage is a known problem. They were horrified to find a total of 2,089.

In fact, this number includes pupils who play truant, have moved away, are home-schooled or are just in hospital. Bradford indignantly released details of its missing children: more than half are boys and only two are South Asian. (Ten are of undeclared ethnicity, but the council thinks few are Asian.) Other councils, equally bemused, report a similar picture.

Still, it is not yet time to call back the search parties. The Forced Marriage Unit receives some 5,000 calls a year asking for advice. On March 11th a report on Luton, a southern town with a large Asian population, found that women's groups were receiving hundreds of inquiries about forced marriage each year, though the local police said they had dealt with only a handful of such cases.

Those cries for help should be better heeded, not least because if ignored they can end in tragedy. Steve Allen of the Association of Chief Police Officers says there are about a dozen “honour killings” a year in Britain, often linked to disputes about marriage. Police awareness of the issue is gradually improving, he says: “We are roughly where we were five years ago in tackling ordinary domestic violence.”

Changes to the law might help. One idea, rejected by the government but still favoured by the Tories, is to make forced marriage a crime. Prosecutors say that existing laws against violence and kidnapping do the job already, and some fear that a new law might deter victims from speaking out, for fear of jailing their parents. A compromise, to take effect this autumn, will allow victims and third parties to apply for injunctions to prevent marriages from going ahead, and to remove women from homes where they are in danger. Those who breach such orders will be arrested. It may still be too big a step for some to take against their own families, but at least the brave ones will be backed up.

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The Liberal Democrats

Better than billed

Mar 13th 2008
From The Economist print edition

Nick Clegg's turbulent early months as leader

LIBERAL DEMOCRATS must wonder why the honeymoons usually enjoyed by newly elected leaders of political parties pass them by. David Cameron, the Conservative Party leader, and Gordon Brown, the Labour prime minister, had hardly a bad headline between them in their first few months at their respective helms. By contrast, Sir Menzies Campbell, the Lib Dems' previous leader, was wounded as soon as he took over by criticism of his parliamentary performances. Nick Clegg, who replaced him in December, has had a testing start to his reign too.

Mr Clegg beat his rival for the job, Chris Huhne (now the party's home-affairs spokesman), by a vanishingly thin margin, which denied him the momentum new leaders often enjoy. His party then conspicuously splintered early this month on the issue of the European Union reform treaty, which Mr Clegg, unlike many of his own MPs, believes should be ratified without a referendum.

Yet for all this the Lib Dems find themselves in reasonable fettle. Their poll ratings, which sank as low as 13% under Sir Menzies, are stable at around 18%. They have been winning council by-elections. And after seeing two leaders undermined by rivals jostling for position they seem united behind their new boss.

Mr Clegg is also giving some ideological definition to a party often derided for being all things to all voters. His speech to the party's spring conference in Liverpool on March 9th was a well-received nod to the liberal, rather than the social democratic, tradition of his party. He even held out the prospect of going into the next election promising a net tax cut, which may tempt Tory voters frustrated with their own party's caution on the matter. Both Sir Menzies and his predecessor, Charles Kennedy, were more comfortable attacking the government from the left.

But the Tories are the Lib Dems' main threat in the majority of their 63 seats. Mr Clegg shares Mr Cameron's youth, privileged background and political style—he even prowled the Liverpool stage without a lectern or a script, as the Tory leader likes to do. But he thinks he can distinguish himself in two ways. One is greater boldness on policy. All three parties want to transfer power from central to local government, for example, but only the Lib Dems support a local income tax. The other is his zeal to change the way politics is done. Mr Clegg wants to renew the reforming tradition of the old Liberal Party with ideas ranging from anti-sleaze measures (he was due to give a speech on money in politics on March 13th) to constitutional reform.

Whatever the vicissitudes of the polls, history, Lib Dems feel, is on their side. In the 1951 election only 3% of the electorate voted for parties other than Labour or the Tories; in 2005, 32% did. And Lib Dems may not have to wait for this realignment of British politics to run its course before wielding power. If neither of the two big parties ends up with a parliamentary majority at the next election—a perfectly conceivable result—they could be king-makers. Mr Clegg, however, tries to dodge speculation about what his party would do in that event beyond demanding radical constitutional change as the price for entering any new government.

This is wise, for the grand sweep of history can be scuppered by more specific problems, and he faces many. One is the challenge of getting more coverage from a press preoccupied by the two main parties. Mr Kennedy was mocked as “Chatshow Charlie” for his appearances on light-entertainment TV but his approach at least ensured exposure. Some say Mr Clegg is not a natural headline-grabber.

An even tougher job is to sell liberal ideas to a party that counts many left-wingers and public-sector workers among its base. Proposals to expand the role of the private sector in health care passed without fuss at the conference, but some Lib Dem thinkers worry that policies to liberate schools from government control will provoke more hostility. “There are many liberals at the top of the party,” says

one, referring to the likes of David Laws and Norman Lamb, who hold the education and health briefs respectively. “But they are fewer the farther down you go.”

The Lib Dems are also unlikely to enjoy again as propitious a set of circumstances as those surrounding the last election. The impressive 22% they scored in 2005 owed much to disaffection with Labour over the Iraq war and to a Tory party that was still unattractive to high-minded floating voters. Mr Clegg faces a fight to keep such voters on board; that he seems to be recovering from a tough start to his leadership suggests he has the stomach for it.

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Bagehot

More unequal than others

Mar 13th 2008
From The Economist print edition

Illustration by Steve O'Brien

The poor, the disgruntled and the envious: whom should the government worry about most?

IF COUNTING sheep doesn't work, insomniacs might instead try counting the number of times Alistair Darling, the formidably soporific chancellor of the exchequer, used the word “stability” in his budget speech on March 12th. “Global financial markets”, “fiscal rules”—he deployed most of the usual catchphrases, though oddly that old standby “boom and bust” was missing. Likewise, though Mr Darling talked about “fairness”, he didn't use an old-fashioned, related term that nevertheless lurked behind much of what he said: inequality. Three different kinds of inequality have survived or arisen under Labour; more than fiscal abstractions, these three inequalities are shaping public perceptions of the government's economic record.

Begin with the traditional kind, the gap between rich and poor—and on the council-housing estates of south Kilburn, one of those bits of London where some of the most deprived people in the country rub up against some of the richest. The West End is only a mile or so away; the posh villas of Maida Vale and Little Venice are round the corner. But, says a local social worker, the knot of high-rise concrete amid the Victorian terraces is “like an island” that many of its residents rarely leave. Cash has flown in, for youth clubs, performing-arts classes and so on. There are sprinklings of satellite-television dishes and a lot of security cameras. But welfare dependency, crime and drugs have been tough to dislodge. A young black man says he is constantly hassled by “crackheads” who assume he is a dealer.

More or less the same picture applies nationally. The minimum wage and Gordon Brown's byzantine tax credits have lifted some people out of poverty. But the “undeserving poor”—those without work or children—have fallen behind, which is partly why, on some measures, overall income inequality has widened since 1997. Despite a whole alphabet of acronymous regeneration schemes, lots of grotty neighbourhoods in London and the north are still stubbornly blighted by unemployment, poor health and despair. And the government is set to flunk its headline poverty goal: to halve the number of children living in relative poverty by 2010, and to end child poverty by 2020.

Morally, that is the most serious of Labour's three inequalities. But, in electoral terms, it may be the least costly. Though the persistence of poverty angers many in the Labour Party, the wider impact is mitigated by a decline in sympathy for the poor, who, polls suggest, are increasingly thought of as lazy and coddled rather than unfortunate. The “victims” of the second kind of inequality are noisier and more popular.

“Deceit and lies”, says one London traffic constable of how the government handled its recent pay row with the police. A detective complains that these days he has to scratch around to find the cash for a trip to the cinema. The police are the angriest of Britain's public-sector workers, but they are far from the only ones aggrieved about pay, and the perceived inequality between public-sector wage settlements and those in business.

In fact, the public sector has done nicely under Labour, especially after Mr Brown, chancellor for a decade, took off the hair shirt he demonstratively wore during his first couple of years in the job. But in the past few years the government has tried to keep public-sector pay increases down to 2%. That is considerably lower than private-sector ones, and as David Cameron, the Tory leader, pointed out in the budget debate, lower than the rate at which the key costs for middle-income households are rising. A nurse from Darlington complains that higher power, transport and fuel bills mean her real income is falling.

Some inequalities are more unequal than others. Griping public-sector workers matter because there are a lot of them—and they are one of the main groups of voters to have turned away from Labour since the 1997 landslide. Grumpy nurses and teachers create an impression that the services they work in are malfunctioning. The only consolation is that (though it is an old trick with diminishing returns) a decent bust-up with the unions can help to burnish Labour's fading reputation for fiscal toughness. There is no such silver lining with the final inequality.

The undeserving rich

A few years ago, a Russian billionaire was asked whether the dodgy privatisations that had enriched him and his ilk had been fair. Of course not, he replied: one of the other oligarchs had got a bigger oil company than he did—which goes to show that wealth alone does not prevent people from feeling hard done by. Perhaps the most worrying sort of inequality for the government is the kind afflicting the middle classes.

If the very poorest have done worst in the past decade, the long City boom, plus Labour's studiously relaxed indulgence of the ultra-rich, have enabled the wealthiest 10% to do best of all. One result of the gold rush for finance and legal types has been leaps in the cost of private education and housing, especially in and around London, where both are now increasingly beyond the reach of the sort of comfortable but unpharaonic middle-class folk who used to be able to afford them. (The recent scandal over Derek Conway, a Tory MP of modest background who apparently fiddled his expenses and sent his sons to a posh school, was among other things a little parable of this economic trend.) The result of this dent in middle-class self-esteem is a growing resentment of the yacht-owning class and of the government that nurtured it—especially in the important swing constituencies in London and the south-east.

Mr Darling did address these real and perceived injustices in his budget. He stuck by the controversial levy on rich non-domiciled foreigners, and boosted benefits for poor families. But Labour's three inequalities, and the grievances they have engendered, may help to defenestrate him and Mr Brown before they can be properly alleviated.

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The UN's oil-for-food scandal

Rolling up the culprits

Mar 13th 2008
From The Economist print edition

AP

America's legal authorities (but not many others) are still clearing debris from the UN programme that an ingenious Saddam Hussein turned to his own advantage

“THE biggest financial scandal ever.” That is what one American senator called the shenanigans over the UN's oil-for-food programme. Designed to soften the impact of UN sanctions on the Iraqi people by allowing the supervised sale of some Iraqi oil, it ended up enabling Saddam Hussein to haul in lots of money and enriching many other shady types. The affair threatened to discredit the whole United Nations system and almost brought down Kofi Annan, its then boss. Even now, the scandal is quietly claiming victims, though in a lot of places it seems to have vanished mysteriously from the radar.

In its final report in October 2005, a committee of inquiry, headed by Paul Volcker, a former chairman of America's Federal Reserve, found that 2,253 firms, many of them household names, had made illegal payments totalling $1.8 billion to the Saddam regime.

That was not quite the world-beating scam claimed by some: the diversion of less than 2% of the value of transactions amounting to nearly $100 billion ($64 billion in oil sales, and humanitarian purchases worth $35 billion) looks almost squeaky-clean by the commercial standards of some energy-rich states. But it was a blot on an arrangement in which every cent was supposed to be monitored. And the Volcker panel's access to ministry files in post-war Iraq threw light on many deals that were meant to stay secret.

Four years after the scandal broke, how many beneficiaries have been brought to book? None in Russia, the country that won the lion's share (nearly a third) of oil deals. As Mr Volcker noted, the programme gave Iraq a freeish hand in choosing its oil clients. It used oil sales to reward people, firms and countries (such as Russia) that were known to be pro-Iraqi.

Predictably, the authorities in Russia shunned the Volcker panel and its findings, which name three Russian bigwigs as beneficiaries of Iraqi oil sales: Alexander Voloshin, a former presidential adviser; Gennady Zyuganov, the leader of Russia's Communists; and Vladimir Zhirinovsky, a nationalist firebrand. Other countries, including China, Cyprus, Yemen, Egypt, Vietnam, Malaysia and the United Arab Emirates, have similarly ignored the report. Of the 52 countries it named, only 28 have asked to consult the tonnes of incriminating documents assembled by Mr Volcker and his 75 investigators. And time is running out. This December all confidential papers will be locked away for 50 years—unless Ban Ki-moon, Mr Annan's successor, extends the deadline.

Although the scandal has disappeared from the headlines, it has not been forgotten: not, at least, in the half dozen or so Western countries most heavily implicated. The United States has led the way. Of just seven people so far convicted worldwide on oil-for-food charges, all were prosecuted in America, which began its legal moves before the Volcker panel reported. Three, including Samir Vincent, an Iraqi-American businessman, and Alexander Yakovlev, a UN procurement official of Russian origin, are awaiting sentence. The other four, including two Americans, got jail terms from one to five years. They also forfeited most of their dubious gains.

David Chalmers, the Texan head of Bayoil, was sentenced on March 7th to two years in jail and ordered to repay $9m in fines and restitution. Oscar Wyatt, another Texas oil man, was jailed in November for one year and ordered to pay $11m. Vladimir Kuznetsov, the Russian ex-chairman of the UN's budget oversight committee, is serving 51 months for money laundering. And Tongsun Park, a South Korean who lobbied for Iraq, is serving five years. Five others are facing oil-for-food charges in America, but have not yet been convicted.

Corporate irresponsibility

America has also moved fastest in probing misdeeds by firms. Over the past 13 months, prosecutors have taken seven companies to court. Five are American: Chevron, El Paso, Ingersoll-Rand, Textron and York International. The two others are Vitol (Swiss) and Akzo Nobel (Dutch). All have agreed to forfeit millions of dollars—$30m in Chevron's case—by way of fines or restitution.

France, which had the second-biggest share of oil deals under the programme, has also been beavering away. Among the 14 people charged so far are Christophe de Margerie, the head of Total, France's biggest oil company; Jean-Bernard Mérimée, a former French ambassador to the UN and adviser to Mr Annan; Serge Boidevaix, a former head of France's foreign ministry; and Bernard Guillet, ex-diplomatic adviser to Senator Charles Pasqua, a former Gaullist interior minister. In India, too, the scandal claimed a high-level victim: Natwar Singh stepped down as foreign minister in November 2005 amid allegations that he and his son had benefited from the scam.

Australia was the first country to launch a national inquiry into the affair (in January 2006). It found the Australian Wheat Board guilty of having paid a mammoth $220m in illegal kickbacks to Iraq. Six of the board's former executives, including Andrew Lindberg, its ex-managing director, are now being sued by the Australian Securities and Investment Commission. After a slow start, investigations in Britain are now progressing. Last year the Serious Fraud Office received special funding of £22m ($44m) to set up a new investigative division with 50 staff devoted entirely to the scandal. More than a dozen firms, including GlaxoSmithKline, AstraZeneca and Eli Lilly, have already been asked to hand over confidential documents.

In Germany, investigators are looking at some 40 as yet unnamed firms; prosecutors refuse to give details. Switzerland says it is investigating 36 firms, which it likewise declines to name, but none is expected to face federal prosecution. Swiss authorities say that 15 cases have already either been dropped or settled through summary penalties. The rest have fallen foul of Switzerland's five-year statute of limitations for such crimes.

The oddity in hindsight is that most of the malefactors seem to have been businessmen, not members of the UN bureaucracy, which many American congressmen denounced as a nest of corruption. So far only two UN officials have been charged with oil-for-food offences—Mr Yakovlev, and Benon Sevan, who ran the programme. Charged with taking nearly $160,000 in bribes, he has fled to his native Cyprus. Arguably, the real culprits at the UN were not its officials but the Security Council, whose five permanent members invented a scheme that was wide open to abuse but who failed to impose the necessary safeguards.

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The illegal weapons trade

Suited and booted

Mar 13th 2008
From The Economist print edition

A notorious arms dealer is arrested in Thailand. Why?

Reuters

Bout: on the other foot now

A FORMER Soviet military-intelligence officer, stranded in Africa by the collapse of his country, turns to gun-running and builds a lucrative international business. It is the sort of outfit that thrives on pointless wars in failed, dirt-poor places. But it also plays a part in some bigger conflicts. Its list of past customers includes the world's best-known terrorist groups, such as al-Qaeda and Colombia's FARC—and Western governments too. Efforts to round up the man at the centre of this web are frustrated, sometimes by bad luck, and sometimes apparently by squabbles in the rich world between those who want to prosecute and those who protect him.

That, broadly, is the critics' account of the career of Viktor Bout, once a Soviet "military translator" in Africa, fluent in six languages, the founder of numerous controversial freight businesses, and now the inmate of a police cell in Thailand, where he was detained on March 6th in a sting operation. Mr Bout says he was on holiday. An extradition affidavit filed by an agent of America's Drug Enforcement Administration (DEA), Robert Zachariasiewicz, says Mr Bout was lured from his home in Moscow to Thailand by people posing as FARC representatives, wanting to buy weapons for a $5m commission. America says it will seek his extradition. On March 10th Mr Bout's British associate, Andrew Smulian, was charged in New York with conspiring to provide material support to a terrorist organisation.

Quite why Mr Bout has now fallen into the clutches of the international justice system is still unclear. Previous attempts to nab him have fallen foul of Western disunity. Clinton-era efforts fizzled out during the Bush administration. Belgian and British attempts to arrest him seem to have been leaked (some blame America for that). Mr Bout appears to have been a useful contractor for American forces in Iraq, and to have trafficked arms to American-backed causes elsewhere. That may have endeared him to the Pentagon, even as the DEA and other agencies were hunting him on other grounds.

Some, such as Louise Shelley, an American academic who researches international organised crime, link Mr Bout's arrest to a broader change in Russia. Semyon Mogilevich, a Moscow-based businessman long wanted by Interpol, was arrested there on January 24th on tax-evasion charges. On March 12th Russia also agreed to extradite to Colombia an Israeli mercenary, Yair Gal Klein, who was arrested late last year in Moscow. He is accused of training FARC guerrillas. But sceptics think any change in Russian co-operation with global law enforcement is cosmetic: "Handing over a couple of ageing arms dealers is a small price," says one, noting strong Russian involvement in Colombia in the past, such as building a submarine for cocaine smuggling.

It is unclear if Mr Bout will ever reach the dock in America. Some who have followed his career closely think he will use "greymail": threatening to expose American secrets. The authorities may prefer to have him spill the beans on something else—perhaps his shadowy backers in the Russian arms-export business—than to risk putting him on trial.

Even more puzzling is why Mr Bout ventured to Thailand at all. Mr Zachariasiewicz's affidavit paints a picture of a man both greedy and careless in pursuit of a smallish deal—implausible for those who believe Mr Bout to have been a meticulous planner with a vast fortune.

But the biggest question of all is what Mr Bout represents. In one sense he was a dinosaur: the product of the Soviet collapse and the opportunities it provided in the form of plentiful cheap weapons and aircraft, highly trained men at a loose end, and weak law enforcement. Those conditions are unlikely to

be repeated (though a close reading of the DEA affidavit suggests, alarmingly, that Mr Bout thought Bulgaria was the ideal place in which to trans-ship advanced surface-to-air missiles).

If true, his alleged activities could also portend a future in which global criminal entrepreneurs disguise illegal businesses (such as drug- and gun-running) within legal ones (air freight), playing off Western governments and their agencies against each other, and using offshore companies and weak legal systems to keep their activities impenetrable. It is easy to imagine such villainy staying ahead of the stumbling efforts of national criminal-justice systems. At least for a time.

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A ravenous dragon

Mar 13th 2008
From The Economist print edition

Newspix

China's hunger for natural resources has set off a global commodity boom. Developed countries worry about being left high and dry, but the biggest effects will be felt in China itself, says Edward McBride (interviewed here)

BESIDE the railroad track, between two hillocks of rust-red soil in the midst of Congo's mining belt, three Chinese labourers appear as if from nowhere. There are lots of Chinese around these days, explains one of their compatriots, Harvey Lee, who is driving through the scrub to the nearby copper plant he runs for a Canadian metals firm. On his way, he points out several rudimentary smelters. “That one”, he says, waving at a clump of corrugated-iron sheds and belching chimneys, “is owned by a man from Shanghai.” Moments later, when another ramshackle compound comes into view, he adds, “and that one belongs to two ladies from Hong Kong.” In all, he reckons, Chinese entrepreneurs have set up half of Lubumbashi's 50-odd processing plants.

All around Lubumbashi, the capital of Congo's copper-rich province of Katanga, there are signs of a sudden Chinese invasion. Chinese middlemen have begun buying ore from the area's many wildcat miners and selling it on to processing plants like Mr Lee's. Locals point out several villas in the city's leafy colonial cantonment that are occupied by mysterious Chinese businessmen. Katanga Fried Chicken, hitherto Lubumbashi's most popular restaurant, now has three busy Chinese competitors.

If all goes according to plan, these fledgling businesses will soon be overshadowed by Chinese investment on a much grander scale. In late 2007 the Congolese government announced that Chinese state-owned firms would build or refurbish various railways, roads and mines around the country at a cost of $12 billion, in exchange for the right to mine copper ore of an equivalent value. That sum is more than three times Congo's annual national budget and roughly ten times the aid that the “consultative group” of Western donors has promised the country each year until 2010. The Chinese authorities, it seems, are so anxious to obtain enough minerals to sustain their country's remarkable economic growth that they are willing to invest billions in a dirt-poor and war-torn place like Congo—billions more, in fact, than Western governments and investors combined are putting in.

And Congo is not the only beneficiary of China's hunger for natural resources. From Canada to Indonesia to Kazakhstan, Chinese firms are gobbling up oil, gas, coal and metals, or paying for the right to explore for them, or buying up firms that produce them. Ships are queuing off Australia's biggest coal port, Newcastle, to load cargoes destined for China (pictured above); at one point last June the line was 79 ships long. African and Latin American economies are growing at their fastest pace in decades, thanks in large part to heavy Chinese demand for their resources.

China's burgeoning consumption has helped push the price of all manner of fuels, metals and grains to new peaks over the past year. Even the price of shipping raw materials recently reached a record. Analysts see little prospect of an end to the boom; the prices of a few commodities have fallen on the back of America's worsening economic outlook, but others, including oil, wheat and iron ore, continue to set new records. China, with about a fifth of the world's population, now consumes half of its cement, a

third of its steel and over a quarter of its aluminium. Its imports of many natural resources are growing even faster than its bounding economy. Shipments of iron ore, for example, have risen by an average of 27% a year for the past four years. Western mining firms are enjoying a sustained boom.

Unwelcome advances

But China's sudden global reach is generating as much anxiety as prosperity. In 2005 America's congressmen, citing nebulous national-security concerns, scuppered the proposed takeover of Unocal, an American oil firm, by CNOOC, a state-owned Chinese one. The opposition candidate in Zambia's presidential election in 2006 made a point of attacking the growing Chinese presence in the country. Residents of Russia's far east fear that China is planning to plunder their oil and timber and perhaps even to colonise their empty spaces.

Some non-governmental organisations worry that Chinese firms will ignore basic legal, environmental and labour standards in their rush to secure resources, leaving a trail of corruption, pollution and exploitation in their wake. Western companies fret that the Chinese state-owned firms with which they suddenly find themselves competing have an agenda beyond commercial gain. The Chinese government, they say, is willing to pay over the odds for mining or drilling rights to secure access to physical resources. It also intervenes unfairly on its companies' behalf, they claim, by offering big aid packages to countries that welcome Chinese investment. All this, it is feared, will dent the profits of big oil and mining firms, stoke inflation and imperil the West's access to resources that it needs just as much as China does.

Diplomats and pundits, for their part, fear that the West is “losing” Africa and other resource-rich regions. China's sudden prominence, according to this view, will reduce the clout of America, Europe and other rich democracies in the developing world. China will befriend ostracised regimes and encourage them to defy international norms. Corruption, economic mismanagement, repression and instability will proliferate. If this baleful influence spreads too widely, say the critics, the “Washington consensus” of economic liberalism and democracy will find itself in competition with a “Beijing consensus” of state-led development and despotism.

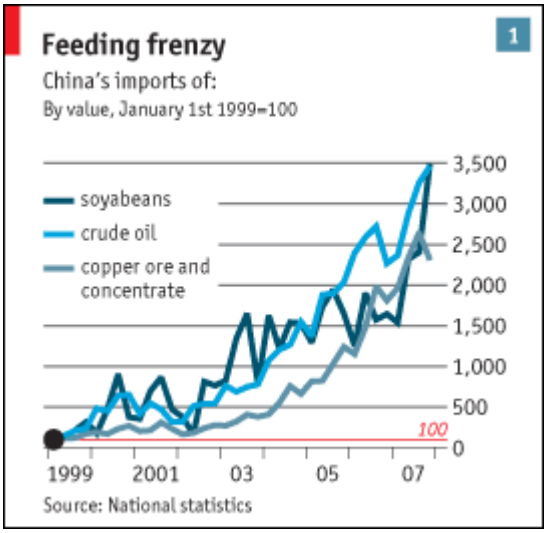
Such fears are not entirely groundless if the recent conduct of some of Congo's neighbours is anything to go by. Angola, to the south, has been receiving so much aid and investment from China that in 2006 it decided it had no need of the International Monetary Fund's billions and all the tiresome requirements for transparency and sound economic management that come with them. Sudan, to the north, has shrugged off Western threats and sanctions over the continuing atrocities in Darfur, thanks in large part to China's readiness to invest in Sudanese oilfields and buy their output. Farther afield, China's eagerness to do business in Myanmar, and its consequent reluctance to chide the tyrannical generals that run the place, helped to prevent a forceful international response to the violent repression of peaceful demonstrations there last year.

Nonetheless, this special report will argue that concerns about the dire consequences of China's quest for natural resources are overblown. China does indeed treat some dictators with kid gloves, but it is hardly alone in that. Its companies do not always uphold the highest standards, but again, many Western firms are no angels either. Fifty years of European and American aid have not succeeded in bringing much prosperity to Africa and other poor but resource-rich places. A different approach from China might yield better results. At the very least it will spur other donors to seek more effective methods.

For all the hue and cry, China is still just one of many countries looking for raw materials around the world. It has won most influence in countries where Western governments were conspicuous by their absence, and where few important strategic interests are at stake. Moreover, as China is becoming more involved in places such as Congo, its policies are beginning to change. It has promised to co-operate with the World Bank in its development efforts in Africa. It no longer seems prepared to back its most objectionable allies in the face of international opprobrium. Its diplomats, for example, did eventually stop parroting their line about unwarranted interference in the internal affairs of a sovereign state and allow United Nations peacekeepers to be deployed in Sudan.

The saga over Sudan shows how sensitive the Chinese

authorities have become to criticism, despite their impassive reputation. When Steven Spielberg resigned as an adviser to the Beijing Olympics in protest at China's failure to do more about Darfur, a shrill chorus of criticism arose from China's official media—suggesting that such gestures do indeed have an impact.



Chinese companies will inevitably find themselves in fierce competition with Western ones for natural resources, as they must if global markets are to work efficiently. For the most part, however, they do not operate very differently from their peers. To the extent that the Chinese government does subsidise oil production, it helps to bring down the price for everyone else (its subsidies for oil consumption are another matter). As the world's biggest consumer of many commodities, China naturally wants to ensure a steady supply of them to keep its economy going. But markets for commodities are global, and the risk of any one consumer cornering supplies, or securing them at a lower price, is negligible.

Own goal

The worst fallout from China's quest for natural resources will be seen not in the countries they come from, nor in the countries that are competing for supplies, but in China itself. Over the past few years the volume of raw materials it consumes per unit of output has risen sharply. In particular, China has gone from miser to glutton in its use of energy, and is now struggling to diet. That has involved bigger imports of oil, gas and coal, and so more foreign entanglements. But it has also led to the rapid depletion of resources that China cannot import, such as clean air and water.

China is building a huge stock of grimy heavy industry, just as its coastal provinces are getting rich enough to care about the consequences. Protests about environmental issues are on the increase. There is not enough water in the Yellow River basin, which covers a huge swathe of northern China, to supply both farmers and factories. Acid rain from coal-fired power plants is reducing agricultural yields, raising the spectre of increased rural unrest. As it is, the authorities are struggling to ensure that the air will be fit for athletes to breathe at the Olympics in Beijing this summer. All the while, the number of noxious steel mills, cement kilns and power plants relentlessly increases. Global warming, which is fed by their fumes, will make all these problems even worse.

Environmental concerns are unlikely to bring down the Communist regime, or even to stir as much resentment as the arbitrary confiscation of land currently does among China's poorest. But those concerns are certainly prompting the government to reflect on what sort of economic path it wants to pursue. So far, its efforts to temper economic growth, encourage energy efficiency and wean the country off heavy industry have had little effect. But continued failure would eventually make China a less prosperous and more unstable place.

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Iron rations

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China is determined to make the most of its own limited resources

Eyepress

The customers are waiting

TO SEE just how quickly China's demand for natural resources is growing, visit Shougang Group, on the outskirts of Beijing. The story of the mill mirrors the chequered history of Chinese industry. This is one of the country's oldest firms, founded in 1919. Nationalised after the Communist takeover in 1949, it was turned into a showcase for the achievements of the People's Republic. Pictures of assorted party bigwigs donning hard hats and greeting the workers adorn the walls. During the Great Leap Forward, Zhou Enlai visited the mill to celebrate its bounding output; in the 1980s, Deng Xiaoping came as part of his drive for "socialism with Chinese characteristics", meaning capitalism with a dose of state ownership.

In keeping with Deng's reforms, Shougang has transformed itself from a model of central planning into a cold-blooded capitalist roader. In the old days the mill was a city within a city, complete with all the frills you would expect from a workers' paradise. It still has its own newspaper and television station, and an internal bus service to ferry workers around its eight-square-kilometre compound. But the company has already shed 180,000 workers and plans to trim 60,000 more, leaving just 20,000. It has offered shares in five subsidiaries to investors on the stockmarkets in Shenzhen and Hong Kong and spent the proceeds on bigger and better facilities. Its steel has been used in many of China's best-known construction projects, including the Three Gorges dam, Beijing's curious egg-shaped opera house and a soaring suspension bridge that spans the Huangpu river in Shanghai.

At the furnaces in the centre of the compound, sparks shower down as a mechanical shovel fills a red-hot crucible with coal and iron ore; molten steel pours from another. A temperature gauge reads 1,127°C. Last year the mill turned out 8m tonnes of steel. But later this year it will close, a casualty of the drive to improve Beijing's air quality for the Olympics.

The demise of Shougang Steel's main plant, however, will not dent the firm's output for long. In conjunction with another Chinese steel firm, it is on the verge of opening an even bigger mill, on an artificial island in the Bohai Gulf in Hebei province, about 220km (140 miles) to the south-east. This will have an initial capacity of almost 10m tonnes. What with the expansion of two other mills in Hebei, Shougang is on course to increase its output from 6m tonnes in 2003 to at least 20m tonnes by 2010. A spokesman says further development is already in the works, and output might reach as much as 30m tonnes soon after. Asked whether the firm is confident that there will be a market for all this steel, he looks puzzled. China is growing so fast, he says, that there is no problem selling anything Shougang produces.

Camera Press

Heigh-ho, heigh-ho, it's off to do our bit for China's economy we go

There are many more businesses making similar assumptions. Shougang ranked only ninth by output among China's steelmakers in 2006. In all, the country has 7,000 of them, twice the number in 2002. Steel production rose by 15% last year, much the same rate of growth as in 2006. Since 2000, China has roughly tripled its output, making it by far the world's biggest producer, with 37% of global output. It accounted for about three-quarters of the global growth in steel production between 2000 and 2005.

China's domestic production of iron ore has more than doubled since 2003, again making the country the world's largest producer. But that has not been nearly enough to supply its proliferating steel mills. So imports have been growing by leaps and bounds too, from 148m tonnes in 2003 to 375m tonnes last year. They now account for half the world's seaborne trade in iron ore. Citigroup, an investment bank, estimates that they will rise to almost 900m tonnes by 2014. And over the past few years it and other banks have had to revise such estimates upwards several times, as demand has consistently exceeded expectations.

Shougang, for example, owns a mine in Hebei, conveniently close to its mills. But that does not provide enough ore for all of them, and other domestic supplies are scarce, so the firm has had to look overseas to make up the shortfall. It bought a mine in Peru in the 1990s and a stake in an Australian one in 2006. In addition to imports from both of those, it also buys ore on the international market. Its new mill is being built on the coast partly to provide easier access for such imports.

Much the same story could be told about many other commodities. Name almost any mineral, and mining firms and investment banks can produce charts depicting how Chinese demand has doubled or tripled since the beginning of this decade. Last year China's copper imports surged by 80%.

China is also importing ever more food. This is partly because more and more farmland is being given over to industry and partly because the population is growing. Moreover, as China becomes richer, its citizens are eating more meat, which contributes to rising food imports: producing meat for people to eat takes more grain than feeding people on cereals.

Squeeze every drop

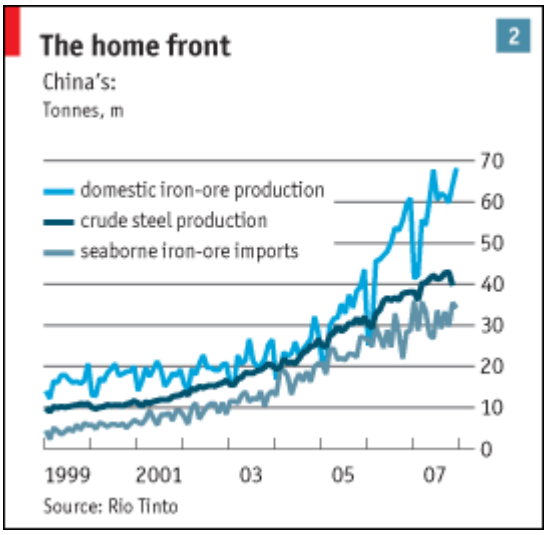
The commodity that best illustrates China's abrupt transition from exporter to importer of resources is oil. In the 1950s Mao Zedong directed his mandarins to find oil to cut China's import bill and reduce the risk of a blockade by hostile capitalists. And find it they did, in the middle of the bare steppe of the north-east, at a place called Daqing. The field turned out to be one of the world's biggest, with over 14 billion barrels of reserves.

This success made Daqing a byword for industrial zeal and heroic self-sacrifice in the name of the revolution. “In industry,” ran one of Mao's most frequently invoked dictums, “learn from Daqing.” Propagandists built up Wang Jinxi, one of the drilling foremen in the field's early days, into a model worker who did not hesitate to risk his life for the good of the people. Chinese schoolchildren are still told how the Iron Man, as Wang is known, flung himself into a bubbling pool of oil and wet cement and mixed it to the right consistency with his own body to cap a well. He survived, just.

The centrepiece of the modern city of Daqing is the Iron Man museum. An imposing statue of the man

himself, sleeves rolled up and chest thrust bravely forward, stands in the middle of a small park opposite, impervious to the icy wind blowing from Siberia. But nowadays Daqing is no longer living testimony to China's indomitable spirit of self-reliance. Rather, it is a symbol of the inadequacy of China's domestic resources in the face of the economy's growing thirst for oil.

Oil production from Daqing peaked at about 1.1m barrels per day (b/d) in 1997. By last year it had fallen to 830,000 b/d, and it is now declining at a rate of about 4% a year. That is better than geologists had expected a few years ago, but slowing the rate of decline has required efforts worthy of the Iron Man. The field is no longer under sufficient pressure for the oil to flow naturally, so Daqing Oil, the subsidiary of PetroChina that runs it, must keep injecting water beneath it to push the oil out of the wells. According to Feng Zhiqiang, the firm's managing director, both injection and extraction wells must be drilled with a margin of error of no more than 50cm to drain every last nook and cranny of the reservoir. The firm also injects special polymers into the field that help free droplets of oil sticking to the rocks.



All this, Mr Feng says, has allowed Daqing Oil to raise the proportion of the field's reserves that it is able to recover from roughly 35% to 45%. He hopes the firm will eventually be able to wring another 10% out of the reservoir by injecting more chemicals. But the operation involves drilling thousands of wells a year and requires a staff of 7,000 engineers.

The firm is also drilling elsewhere in the same basin in the hope of finding more oil. It has made some discoveries, but mainly of natural gas. Such new oil as it has been able to find adds up to only about 700,000 barrels a year, less than the main field produces in a day. Moreover, smaller, dispersed fields are more difficult and expensive to exploit. As Mr Feng observes with a stoic sigh, “even the thinnest camel is bigger than the fattest donkey.”

Throughout China geologists are discovering more donkeys than camels these days. Production has peaked at 10 of the 11 biggest oilfields in the country, according to the International Energy Agency (IEA). The overall amount of oil produced rose marginally in 2007, after remaining flat in 2006. But the IEA forecasts that this, too, will peak at 3.9m b/d in 2012, and then start to decline.

It hardly needs saying that China's demand for oil is moving the other way. More and more Chinese are trading in their bicycles for motorbikes and cars. Between 2000 and 2006 the number of new cars sold grew by an average of 37% a year, making China the world's second-biggest market. The IEA reckons it will overtake America to claim the top spot in 2015. The amount of oil used by Chinese industry, along with the transport networks that feed it, is growing rapidly too.

Back in 1990, China consumed just 2.4m b/d, leaving 400,000 b/d of domestic production for its oil firms to export. Now it guzzles over 7m b/d, about half of which it has to import. The IEA thinks that by 2030 it will gulp 16.5m b/d, of which some 13.1m b/d will have to be bought abroad. That is more than the current total output of Saudi Arabia.

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The lucky country

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Australia can't dig fast enough to meet demand from China

AFP

The Pilbara's vehicle for growth

CHINA'S insatiable appetite for commodities has been manna from heaven for the countries and firms that supply it. Take the iron ore that feeds the smelters of Shougang Steel and its rivals. Three mining conglomerates, BHP Billiton, Vale and Rio Tinto, control about 70% of the world's trade in iron ore. Each year they negotiate annual supply contracts with their main customers, and as demand has surged, so has the price. In 2005 it rose by a whopping 72%. The rate of increase subsequently slowed, but this year some importers have agreed to rises of 68% or more. Even after these swingeing increases, demand still outstrips supply.

Rising prices have brought rising profits. Vale's quarterly earnings have grown tenfold since 2002 (partly thanks to its takeover of Inco, a Canadian rival). Rio Tinto's share price almost doubled in 2007 alone (helped by its own takeover of Alcan, a Canadian aluminium firm). Now BHP is trying to buy Rio Tinto, in part to accelerate the growth of its iron-ore business. All these mergers and bids reflect the fact that mining firms have themselves become a hot commodity, growing in lockstep with China.

The three firms are all frantically expanding their iron-ore business to make the most of the windfall prices. The main beneficiary is Australia, the world's biggest exporter of iron ore. The output from Rio Tinto's mines in the Pilbara, in the country's arid north-west, has increased by an average of 15% a year since 1999. Between now and 2013 it plans to double its output, perhaps even triple it if necessary. Most of that would come from the Pilbara, which is closer to China than rival sources of ore. But starting in 2013, Rio Tinto also plans to ramp up production at an enormous new mine in Guinea.

Rio Tinto says it would be expanding even faster if it could. It more than doubled its capital expenditure between 2004 and 2007, and plans nearly to double it again by next year (again, the takeover of Alcan has played a part). But it is constrained by runaway inflation within the industry as mining firms everywhere race to invest. Growth has been so fast that suppliers cannot keep up, creating physical shortages of crucial inputs, such as tyres for the massive trucks that haul ore around the mines and locomotives to pull the long ore trains from the mines to the coast. The delivery time on both, says Tom Albanese, the firm's boss, is currently two years.

Rio Tinto is trying to teach its staff to drive more gently to extend the life of its tyres. It is also trying to automate more of its equipment so as to limit the number of workers who have to live in the singeing, barren scrubland of the Pilbara—and ease a chronic shortage of both skilled and unskilled labour. Mr Albanese says that recruitment of engineers in Australia has risen from a few dozen a year in the lean decades of the 1980s and 1990s to hundreds now. It does not help that BHP and various other mining firms are also trying to expand their output in the Pilbara as fast as possible, and that several oil companies are building or extending liquefied-natural-gas (LNG) plants in the area—with China as an

important customer.

The shopping mall in Karratha, the area's main town, is full of “help wanted” signs. The local unemployment rate is 2.2%, less than half that for Australia as a whole—which is itself at its lowest for 30 years. Demand for goods and services in the Pilbara's home state, Western Australia, grew by 11% in the year to last September, faster than in China itself. The state's chamber of commerce predicts that this will slow to a somewhat less meteoric 6.5% this year and continue at 6% or so for some time—the chief constraint being the lack of able bodies to employ.

Last year Western Australia exported some A$8.5 billion-worth of iron ore to China. Helped by these exports, the state of Western Australia and the national government are both running handsome budget surpluses now. Chinese investment in Australia's iron-ore business is also booming. Gindalbie, an Australian iron-ore miner, and Ansteel, a Chinese steelmaker, agreed last year to invest A$1.8 billion in a joint venture to develop a mine in Western Australia.

Mine, all mine

Sinosteel, a big Chinese minerals firm, has bid A$1.2 billion for Midwest, a Western Australian iron-ore producer, trumping an offer of A$900m from Murchison, one of Midwest's local rivals. Chinese firms are even said to be thinking about a counterbid for Rio Tinto, to prevent BHP from cornering the market for ore. At any rate, Chinalco, a Chinese state-owned mining giant, recently teamed up with Alcoa, an American aluminium firm, to buy 9% of Rio Tinto's shares.

And iron ore is only part of the story. Australia is also the world's biggest exporter of coal, which brings in even more revenue than iron ore, and of alumina, used for making aluminium. Its exports of diamonds, zinc, lead, gold, nickel, manganese, copper and LNG are also growing rapidly, especially to China. Australia's farmers, for their part, are sending lots of beef, wheat, lamb and dairy products to China. China is now Australia's second-biggest market for agricultural goods, and the fastest-growing.

No worries

Australians' response to all this has been overwhelmingly positive. Politicians of all stripes vie with each other to be seen as China's friend. When John Howard was prime minister, he invited Hu Jintao, China's president, to make two state visits in the space of four years. The most recent one, which took place just before a big international summit in Sydney last year, was seen as a bid to raise Mr Howard's standing ahead of an election. But Kevin Rudd, then leader of the opposition, upstaged Mr Howard with his fluent Chinese. Mr Rudd, who went on to win the election, gave an interview to China's state-owned television network in which he promised to elevate Australia's relations with China “to a whole new level”.

Australians do not seem to suffer from the faint unease about China's rapid growth that often afflicts Europeans and Americans. Instead, they see China's rise as an opportunity. In a poll conducted last year by the Lowy Institute, a think-tank, a majority of Australians said they had positive feelings towards China and saw it as their country's most important economic partner. Only 19% said they were very worried about China's growing power.

Some Australian pundits have questioned the wisdom of allowing Chinese firms to buy so many mineral rights. But they have similar misgivings about all foreigners. In 2001 the Australian government barred Royal Dutch Shell, a Western oil giant, from taking over Woodside, Australia's biggest dedicated oil company, on much the same grounds. There are also fears that Australia might become over-dependent on China—but that is a sign of its enthusiasm for doing business with China, not of any reticence.

It is important to keep China's role in the Australian economy in perspective. It was not until last year that China unseated Japan as Australia's biggest trading partner. It still accounts for only 14% of the continent's exports, and in 2006 it ranked only 17th for foreign investment in Australia. These figures are bound to rise, and China's appetite for natural resources is already making a big difference to Australia's growth. But it is not the be all and end all of the Australian economy.

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Mutual convenience

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From The Economist print edition

Congo has something China wants, and vice versa

IN POORER countries such as Congo, China's hunt for resources has more complex effects. On the one hand, Congo's long-deprived citizens are in much more desperate need of trade, investment, economic growth and the rising living standards they might bring with them. On the other hand, its corrupt and underfunded government is much less able or inclined to manage China's engagement for the benefit of its people. Nonetheless, even from the pot-holed streets of Lubumbashi, China's new needs seem like a momentous opportunity.

Congolese are constantly pointing out that their country should be one of the richest in the world. It has huge mineral wealth, including the world's biggest reserves of cobalt and tantalum, a rare metal used in the circuitry of mobile phones and laptops. It also has rich seams of copper, diamonds, gold, manganese, uranium and zinc. And much of the country is covered with virtually intact tropical forests, thick with valuable hardwoods.

In fact, though, Congo is one of the poorest countries in the world. Output per head is just $714 a year, the third from the bottom in the United Nations' global ranking—even after adjusting for the lower cost of most staples in poor countries. Over half of its citizens do not have access to clean water, and the life expectancy of a newborn baby is less than 46 years. Kinshasa, the capital, has some 15m inhabitants but no sewage system.

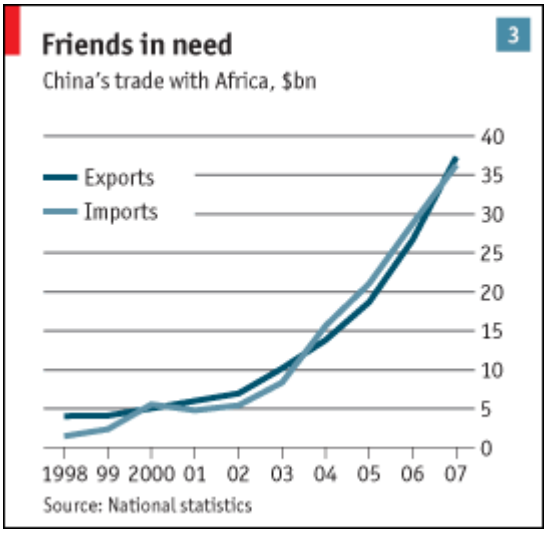
Dirt poor in the midst of plenty

In short, Congo has made very little of its natural resources. The Economist Intelligence Unit, a sister company of *The Economist*, estimates that the country's exports last year were worth only $2.6 billion—a paltry sum in a country of 60m people. This pitiful performance stems first from exploitative Belgian colonialism; then from the kleptocratic misrule of Mobutu Sese Seko, who ran the place for more than three decades until his overthrow in 1997; and then from the on-again-off-again civil war that has wracked the country ever since. Sporadic fighting continues, although UN peacekeepers have managed to instil a semblance of order which allowed elections to be held in 2006.

Western donors paid for the elections, which cost $460m, and have supported the resulting government with substantial handouts. This year's budget, for example, envisages aid of $1.3 billion—although it is not clear whether this will be forthcoming. The government has had testy relations with the International Monetary Fund, which thinks it is too lavish in its spending. That, in turn, has prevented Congo from joining the “Heavily Indebted Poor Countries” initiative (HIPC), under which Western donors agree to write off some of the debt of the poorest countries as long as the IMF approves of their economic policies.

While negotiations with the IMF on a reform package drag on, interest payments on Congo's foreign debt of $12 billion are consuming a large chunk of the budget. The remainder goes mainly to pay civil servants, leaving little for development. Moreover, complains Barnabe Kikaya bin Karubi, a member of the National Assembly and a former presidential spokesman, once the holes in the budget have been plugged, most Western aid goes into education and health care. These are important, he argues, but they do little to stimulate the economy in the short term. And all Western aid, he gripes, comes with endless strings attached: “If we say to the Europeans that we want a highway, they say, 'hold an election first, sort out your finances, crack down on corruption'—and in the end the highway never gets built.”

Congo is also receiving some private capital. Freeport McMoRan, an American mining conglomerate, has started construction of a $650m copper mine in Katanga province and hopes to begin operations by the end of this year. Last October Katanga Mining, which is listed in Toronto, secured a loan of $150m to finance the development of another copper mine nearby. The same month BHP Billiton agreed with the Congolese government to look into the construction of an aluminium smelter in the province of Bas Congo, at a cost of roughly $3 billion.



But Western firms are cautious. Freeport's mine, for example, has been in the works for over a decade as various prospective investors have balked at Congo's instability and dropped out. It has taken encouragement and financing from bodies such as the African Development Bank, the European Investment Bank and America's Overseas Private Investment Corporation to get the project up and running.

For several years now the World Bank has ranked Congo as the worst place in the world, bar none, to do business. It has a totally dysfunctional legal system, a hugely cumbersome bureaucracy and a near-total lack of physical infrastructure. Kinshasa suffers from paralysing traffic jams, due not to a surfeit of cars but to the appalling state of the roads. Last year analysts and businessmen surveyed by Transparency International, a pressure group, ranked it 168th out of 179 countries for freedom from corruption. To top it all, the government is conducting a much-needed but opaque and long-winded review of all mining contracts signed during the civil war, adding to foreign investors' anxiety.

None of this seems to deter China's state-owned firms, however. Last September Export-Import Bank, through which the Chinese government disburses all its foreign aid, signed an agreement with the Congolese government to finance $6.5 billion-worth of improvements to the country's infrastructure and $2 billion-worth of construction and refurbishment of mines, using mineral reserves as collateral. The following month a similar deal was signed with China Development Bank.

Victor Kasongo, the deputy minister of mines, says the total value of these deals could eventually reach $14 billion, a conservative estimate of the value of the 3.5m tonnes of copper reserves the government has set aside as collateral. The state-owned mining firm, Gécamines, also holds the rights to a further 13.5m tonnes of copper reserves, so if the model proves successful there is enormous scope for expansion.

Joseph Kabila, Congo's president, has labelled the Chinese deals as “exemplary co-operation”. “For the first time in our history”, he told the National Assembly, “the Congolese people will finally be able to see what the use of their cobalt, nickel or copper will have been.”

But Western governments have all sorts of questions. For one thing, they are loth to forgive billions in debt to Congo only to see it rack up similar obligations to China. They also want to be sure that firms from their countries will not suddenly find themselves at a disadvantage to Chinese ones with political connections. Nor do they want to be put at a disadvantage themselves, with little leverage over a Congolese government flush with Chinese cash. At best, that would jeopardise their recent efforts to steer Congo towards solvency and democracy. At worst, it might help to rekindle the civil war, undermine stability in the region and put 18,000 UN peacekeepers at risk.

Reuters

The power of picks and shovels

It is true that China has sold arms to the Congolese government. But if those arms help to stem the various rebellions wracking the country, they might actually make it more stable. At any rate, China is not the only outside power to go down that road: the UN's peacekeepers, despite their title, have joined the Congolese army in an offensive against one of the most disruptive rebel groups. It is hard to see how provoking instability in the area would be in China's interests. After all, it would make it harder to get at the minerals which Chinese firms are so keen to secure. It would also generate embarrassing publicity, especially in the run-up to the Beijing Olympics in August.

It is also true that Congolese politicians chafe at the dictates of the IMF. But Congo is so poor that it cannot afford to turn its nose up at either Western or Chinese money. The government certainly could not do without the funds European donors have lent it to help balance the budget. It also desperately needs the debt relief that only the IMF can provide, through the HIPC scheme, so it is trying to get back in the fund's good books.

Anyway, there is no sign that China intends its aid as a substitute for Western handouts. In December the World Bank and China agreed to develop aid projects in Africa together. Chinese diplomats have begun attending the meetings in Kinshasa at which Western donors try to co-ordinate their development schemes, says Ross Mountain, the local head of the United Nations Development Programme. He sees no problem with a big increase in Chinese aid: the more the merrier.

The same goes for mining firms. The Congolese authorities insist that Western companies have nothing to fear from the sudden appearance of Chinese rivals. No sooner had the Chinese deals been signed than Mr Kabila flew to America to reassure both the American government and Freeport McMoRan. “We want all investors,” says Moise Katumbi, the governor of Katanga province. “We don't care what colour they are.” Mr Kasongo vows that no existing mining concessions or contracts will be voided to make way for Chinese investors. As long as Congo has undeveloped mineral deposits, he argues, it would be counterproductive to do so.

The Chinese government may well seek to use its clout on behalf of its companies, but Western governments do the same all the time. Congolese politicians like to point out that France's president, Nicolas Sarkozy, has been flitting from country to country, badgering officials to buy reactors from Areva, a French nuclear firm. And it is not as if the new Chinese arrivals were subverting a perfectly transparent system of allocating mining licences. Almost all Congo's existing mining contracts were negotiated with little scrutiny by governments of dubious legitimacy—hence the decision to review them.

Without fear or favour

The authorities do not appear to be going especially easy on the Chinese businesses that already have a presence in Congo. Mr Katumbi says he has expelled 600 Chinese found working in Katanga without proper documentation. “This week I closed three Chinese companies,” he adds proudly, citing environmental abuses. At the special office he has set up to enforce mining and customs regulations, employees show off a huge block of malachite that one Zhang Cao had tried to smuggle out of the country. A close eye, all the staff agree amid much tutting and shaking of heads, needs to be kept on Chinese firms.

That attitude should encourage Congolese and foreign NGOs who worry about how the new Chinese investors will behave. They point to neighbouring Angola, where China is paying for the construction of roads and railways but is using mainly Chinese contractors and workers, denying work to the legions of

unemployed locals. There are also fears that Chinese firms will cut corners on quality, or ignore labour laws and environmental standards, or simply not prove up to the job. Some ask whether the Chinese will come to resemble European colonialists of the past, neglecting Congo's development as they loot its natural resources.

No colonialists here

But Congolese officials seem determined not to be taken for a ride. Mr Kabila has said that Chinese firms investing in the mining sector will have to take on Gécamines as a partner, process the ore they produce before exporting it and employ as many locals as possible. Mr Kasongo adds that the government will set tough deadlines for the completion of the roads and railways to be built under the ore-for-infrastructure deals, the details of which are still being negotiated. And Mr Kikaya, the MP, gives warning that the National Assembly will not tolerate “shoddy work”.

The small Chinese companies that are already operating in Katanga do not seem to behave any better or worse than their competitors. At the smelter in Lubumbashi run by Mr Lee, three-quarters of the employees are local. The trading firms that buy the smelter's output are Swiss and Belgian, he says, not Chinese. Global Witness, a pressure group, has complained about the exploitation of wildcat miners, but the main objects of its ire are Lebanese- and Indian-owned mineral-processing and export firms. It says that Chinese tradesmen, by contrast, have a reputation for paying miners promptly and well. In 2001, a United Nations report on the looting of Congo's natural resources named a number of African and European companies that were said to be pillaging the country but no Chinese ones.

Chinese firms do, however, seem to move faster than their foreign rivals. Mr Lee says that his smelter went up in six months, a quarter of the time it has taken an Indian firm to build a similar facility on an adjacent plot. Mr Katumbi, the governor, says Chinese firms find it easier to finance investment in Congo because Chinese banks have steelier nerves than their Western counterparts. Chinese companies are also keen to upgrade their plants, he says, and to expand into other businesses—something other foreigners are reluctant to do.

As for the idea that China's sudden interest constitutes a new form of colonialism, Congolese politicians seem to see it as the opposite: an opportunity to put meddling foreigners in their place. China's growing presence, Mr Kikaya says, might encourage Western governments to drop their “patronising attitude, that we know what's best for you”. He also points out that China has got involved in Congo before. In the 1970s Chinese workers came to construct a parliament building that is still in use today. In the 1990s another contingent arrived in Kinshasa to build the national stadium, Africa's largest. Those projects did not turn Mobutu into a Chinese stooge; if anything, he was seen as an American puppet.

As in Australia, some perspective is needed. China is only one of a number of countries with interests in Congo's minerals and influence over its politicians. As Mr Kasongo points out, all the government is proposing is to put 3.5m tonnes of Congo's copper reserves into Chinese hands. That is only one-third of the amount controlled by a single American firm, Freeport, as operator of Congo's huge Tenke Fungurume mine. Indeed, the biggest worry about the deal with Congo is whether it will go ahead at all: six months after it was first announced the two sides are still haggling over the details.

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No strings

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Reuters

Rolling out the welcome mat

Why developing countries like doing business with China

CONGO'S experience of China is fairly typical of most resource-rich but otherwise poor countries. For both Africa and Latin America, China is still only the third-biggest trading partner, after the United States and the European Union—although its trade with both continents is growing very fast. In terms of investment, China ranks even lower.

The only countries where China has become the pre-eminent ally and commercial partner are those that have been ostracised by the West, such as Myanmar and Sudan. In both places China's diplomatic support and investment has made it easier for nasty regimes to defy international pressure. And in both places China's pay-off comes in the form of natural resources.

Chinese firms have invested $15 billion in Sudan since 1996, largely in the oil industry. That has allowed the country to raise its production from almost nothing to over 500,000 b/d, hugely boosting government revenue. The arrangement has been particularly beneficial for Sudan because American sanctions in place since 1997 have kept some of the biggest international oil companies out of the country. But it has also been a boon for China because Sudan is one of the few foreign countries where China National Petroleum Corporation (CNPC) has been able to buy a big stake in some prolific oilfields and been allowed to manage them directly (see article). Some 10% of China's oil imports now come from Sudan.

That has given China an incentive to reject sanctions on Sudan whenever they have been proposed in the UN Security Council. The oil revenue, meanwhile, has provided the Sudanese government with the cash to wage war. In fact, Chinese firms have gone further and built arms factories in Sudan, which have proved particularly handy since the UN imposed an arms embargo in 2004.

Myanmar is a source of timber, gems and food for China. If all goes according to plan, it will soon serve as a transit route for oil from the Indian Ocean to southern China, providing an alternative to the crowded Singapore Strait. Myanmar is also said to play host to a Chinese military surveillance station which provides critical intelligence on India. Myanmar's military junta, in return, can count on China to defend it against other countries. Last year, when it began shooting at protesters, China vetoed the sanctions that America proposed in the Security Council.

But the West was at loggerheads with Sudan and Myanmar long before China developed its appetite for natural resources. Chinese diplomats say they did not cause the abuses that Westerners are complaining about, so should not be held responsible for dealing with them. China has not been the only country to break ranks: Malaysia's and India's state-owned oil companies also have investments in Myanmar and Sudan. Russia, for its part, vetoed America's bid to impose sanctions on Myanmar last year, and Thailand

buys Myanmar's natural gas.

China is not just cultivating these countries so that it can lay its hands on their natural resources. He Wenping, of the Chinese Academy of Social Sciences, says it also wants to counter Taiwan's efforts to win diplomatic recognition and to garner support in bodies such as the World Trade Organisation and the United Nations. Encouragingly, that seems to suggest that China is trying to bolster its position within existing international institutions, rather than to create rival networks of disaffected pariah states.

As a repressive regime itself, the Chinese government clearly has an interest in advancing the principle that outsiders should not interfere in the affairs of other countries, however repressive their regimes. But as China's international ties become more complicated, argues Chris Alden of the London School of Economics, Chinese diplomats are beginning to moderate their reflexive stand against interference. Wen Jiabao, China's prime minister, has called for democracy in Myanmar. China has also changed its stance on Sudan as international outrage about events in Darfur has grown and activists have branded the Beijing games as “the genocide Olympics”. Last year China helped to persuade Sudan to admit UN peacekeepers—a move it had long resisted, with China's blessing. China has even sent troops of its own to join the UN force.

Play by the rules

At the same time resource-rich countries are becoming more demanding. In 2006 the government of Gabon, having discovered that Sinopec, another Chinese state-owned oil firm, did not have the required environmental permits, ordered it to halt a big drilling project in a national park. Peru has fined Shougang Group several times for abuses of labour law and breaches of its initial investment contract. The government of the Philippines has suspended a Chinese firm's $3.8 billion scheme to grow grain for export after a series of Chinese investments became the subject of a bribery scandal. Chinese mines in Zambia have suffered from labour unrest. The naive notion that stronger commercial ties offer lots of painless “win-win” opportunities to both China and the resource-rich countries of Africa and Latin America is coming under greater scrutiny on both sides.

Developing countries are understandably keen to ensure that they get the maximum economic benefit from their extractive industries. Russia, for example, is gradually ratcheting up its export tax on raw timber so that the Chinese firms now simply harvesting wood in the forests of Siberia will have to set up sawmills there as well. That will spell the end of the dozens of wood-processing firms that have sprung up across the border in the Chinese town of Manzhouli.

The governments of both Brazil and Argentina have said they want to export more than just minerals and food to China, and have begun to stem the flood of cheap Chinese imports they are receiving in return. As Thabo Mbeki, South Africa's president, has put it, “China cannot just come here and dig for raw materials and then go away and sell us manufactured goods.”

The benefits of China's growing appetite for natural resources to the producer countries are clear. Increased Chinese demand and the higher prices that go with it have boosted both the volume and the value of their exports. For countries that also sell manufactured goods the calculation is less clear-cut but probably still positive. Chinese competition may have driven up the cost of inputs of raw materials, kept wages low and reduced the selling price of manufactures, yet in most cases this is more than outweighed both by growing Chinese demand for imports and by the global boost to purchasing power from cheap Chinese manufactures.

A recent World Bank study simulated the effects of China's and India's growth on the rest of the world, starting from various assumptions. In every case it came up with positive results for all but a handful of European and Asian countries.

Similarly, a series of reports from the World Bank, the Inter-American Development Bank and the Organisation for Economic Co-operation and Development concluded that China's emergence is beneficial to Latin America. The most recent one, from the World Bank, found strong evidence that Chinese demand was boosting Latin American exports and little indication that Chinese exports were crowding Latin American ones out of other markets. It seems that for resource-rich countries the main risk of China's hunger for commodities is that it might wane.

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Intrepid explorers

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China's mining and oil firms pop up everywhere

DO CHINA'S state-owned mining and oil firms have an unfair advantage over their Western rivals? They certainly have deep pockets: in 2006, for example, Sinopec, one of China's three big state-owned oil firms, raised eyebrows when it offered a record price—over $2 billion—for the right to explore for oil in three parcels of Angola's territorial waters. In 2005 one of the others, CNOOC, lined up billions of dollars in cheap loans from state-owned banks to fund its ill-fated takeover bid for Unocal, an American oil firm.

That hints at the official backing China's big resources firms seem to enjoy. Since 2002 the government has exhorted them to seek their fortunes overseas. The National Development and Reform Commission, a planning ministry of sorts, keeps a list of countries where it encourages Chinese investment with special incentives. Chinese aid to Africa seems to be concentrated in countries where Chinese resources firms are also investing heavily, such as Sudan and Angola.

All this has stirred fears that Chinese firms, in cahoots with their shareholders in government, are squeezing out Western competition and locking up supplies of natural resources for the future. But, points out Erica Downs of the Brookings Institution, a think-tank, Chinese oil firms usually invest overseas in partnership with Western firms or other national oil companies (NOCs). Moreover, they tend to be passive shareholders, not operators that exercise day-to-day control over the investment. And they mostly sell their share of the oil produced on the open market, rather than spirit it back to China.

Wood Mackenzie, a consultancy, has examined the prices paid by Chinese oil firms for acquisitions and exploration rights and calculated that most of them are likely to earn a very respectable rate of return of 15-20%. “The contention that ‘win at all costs’ tactics are being pursued by the Asian NOCs in asset acquisitions is simply not substantiated,” Wood Mackenzie concluded.

Chinese firms do have access to countries that many Western ones do not, such as Sudan and Iran—but if they are exploiting oil that would otherwise go undeveloped, they are increasing the global supply and so reducing the price. They also seem to have access to cheaper capital, and are not being required to pay onerous dividends to the state. But again, that means Chinese banks and taxpayers are subsidising oil production, reducing the price the rest of the world has to pay.

Besides, Chinese firms are not as invincible as they are made out to be. After all, Chevron, an American oil firm, managed to snatch UNOCAL from CNOOC's jaws. And Chinalco is struggling to prevent BHP Billiton's proposed takeover of Rio Tinto.

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A large black cloud

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AP

Troubled waters

Rapid growth is exacting a heavy environmental price

CHINA will not continue to grow at the same pace as it has done recently, or suck in as many raw materials, if its leaders get their way. The 11th Five-Year Plan, which lays out their main economic goals for the period from 2006 to 2010, calls for growth to slow to 7.5% a year from its current double-digit pace and for consumption of energy—a good proxy for resources in general—to decelerate even more.

The government has several motives for stepping on the brakes. One is simply to allow its bureaucrats time to plan for and direct growth. Its chief aim is to redress the growing inequality between the prosperous coastal provinces and the poorer interior ones, and between cities and the countryside. But slower, more carefully orchestrated growth might also avoid wasteful and disruptive bottlenecks.

In 2003, for example, electricity consumption surged so unexpectedly that China began suffering from repeated brownouts as the grid ran short of power. That prompted millions to buy diesel generators, which in turn led to a 10% jump in oil imports in 2004. Since then electricity companies have been building power stations with gay abandon. In 2005 and 2006 they added more generating capacity than France has in total. That has boosted demand for coal, since most of the new plants are coal-fired. But most of China's coal comes from the country's interior and must be transported to coastal power stations by train. That is using up a lot of diesel (on which the trains run) and clogging up the rail network. So power stations have begun shipping in coal from overseas, turning China into a net importer in the first half of 2007 and prompting the huge queues of freighters outside coal ports such as Newcastle, Australia. These lurches in demand for different resources have added to the jitters in commodity markets and helped to amplify price rises.

The government is also worried about security of supplies. Senior figures still daydream about self-sufficiency, looking back to Maoist doctrine and to the terrible man-made famine of the late 1950s. They fret, too, that foreigners might attempt to blockade the country in the event of a war over Taiwan. In particular, the government is anxious about its oil imports from the Middle East and Africa, all of which pass through the narrow Singapore Strait. So it has been pushing for alternative routes, such as a pipeline from Kazakhstan, which opened in 2006, and another one from Russia, which has been under discussion for the past decade. The government has also created, and started filling, a strategic reserve, which should eventually hold 30 days' worth of imports, says the IEA.

The environmental fallout from China's burgeoning demand for natural resources is another source of concern. Processing iron ore, timber or oil requires electricity, and 80% of China's electricity comes from coal. But the sulphur that spews from the smokestacks of coal-fired power stations causes acid rain and the soot generates smog. In many Chinese cities, a thick shroud of pollution literally blots out the sun much of the time. Acid rain, meanwhile, reduces agricultural yields and eats away at buildings and

infrastructure. The OECD cites a finding that air pollution alone reduces the country's output by between 3% and 7% a year, mainly because of respiratory ailments that keep workers at home.

A dry subject

China's water supply, too, is in a parlous state, thanks to ever-increasing industrial and agricultural use. The amount of water available per head of population is only a quarter of the global average. In the arid north and west of the country that figure falls to a tenth. Two in three cities already suffer from shortages. Groundwater is being pumped out much faster than it is being replenished.

Not even Beijing treats all its sewage; other cities treat none at all. Famous beauty spots, such as Taihu Lake near Shanghai, are often afflicted by hideous algal blooms, while effluent from polluted rivers has contaminated 160,000 square kilometres of ocean off China's shores, officials say. Over half the water in the seven biggest river basins is unfit for consumption, according to a recent report from the World Bank. The resulting health problems reduce rural output by 2%, it found, and the costs to industry and agriculture of dirty and scarce water sap GDP by another percentage point.

All told, the World Bank put the price tag for China's air and water pollution at $100 billion a year, or about 5.8% of GDP. It is said that the same report originally put the number of deaths caused by the two scourges at 750,000 a year—until the Chinese government complained and asked for the figure to be removed. Pan Yue, a deputy minister at the State Environmental Protection Administration (SEPA), China's paramount environmental regulator, estimates the annual cost of environmental damage at 8-13% of GDP—much the same as the overall economic growth rate. If it continues like this, he expects levels of pollution to double over the next 15 years.

Then there is global warming, which is already exacerbating China's environmental problems. The latest report from the Intergovernmental Panel on Climate Change notes that temperatures in China are rising and extreme weather, including cyclones, droughts and floods, is on the increase. Worse, the Himalayan glaciers that feed China's biggest rivers (and account for a large portion of flows during dry spells) are melting. “If the present rate continues,” the report says, “the likelihood of them disappearing by the year 2035 and perhaps sooner is very high.”

Among other things, this will make life even more difficult for China's farmers. Northern China, which lost some 36,000 square kilometres to desertification between 1990 and 2000, will become even more arid. Its water supply, the IPCC predicts, will fall 30% below requirements. Moreover, rice yields will drop by 10% for every degree the temperature increases. Rising sea levels and the associated intrusion of salt water are likely to reduce the amount of arable land even further.

As it is, in villages like Beihuadan, in Hebei province, just a few hours' drive from Beijing, the water table is already falling rapidly. A shuffling farmer in a flat cap and worn woollen sweater pumps furiously at the well in the courtyard of his house to show that it has run dry. It is only 19 metres deep, he explains, but there is no water these days for at least 70 metres, and often not for 100 metres or more. A few houses away a group of old men interrupt a game of cards to point out another dry well. For five years, they say, there has been no water in the Beijuma river, which runs past the edge of the village, and the authorities do not provide adequate alternatives supplies through the local irrigation network.

The government is planning to invest billions in a system of canals, pipelines and aqueducts to divert water from the soggy south to the parched north. But the scheme is only a temporary fix, and is just the sort of grandiose engineering project that tends to cause environmental problems of its own. Many NGOs and hydrologists are adamantly opposed.

As it is, the environment is the second most frequent subject of public protests after disputes over land, according to Mr Pan. In 2005 the authorities recorded 50,000 such protests, he says, and that was a 30% increase on the year before. Last year 10,000 people turned out to demonstrate against a planned chemical plant in the city of Xiamen. Earlier this year hundreds of Shanghainese protested against a proposed extension to the city's maglev train, worried about health risks. Such protests are particularly unnerving for the authorities because they involve educated, articulate and well-organised urbanites, not the country folk who normally suffer most from abuse by officials.

The best response to all these worries is to encourage more sparing use of resources, and that is what the government is trying to do. The current five-year plan, which contains few other numerical targets, envisages a 10% reduction in concentrations of the worst air pollutants and a 20% increase in energy

efficiency over the period. The central government has assigned specific energy-efficiency goals to each of China's 1,000 biggest enterprises and encouraged lower levels of government to do the equivalent.

Eyepress

Still belching

The government has set relatively stringent fuel-economy standards for cars, as well as minimum energy-efficiency requirements for all manner of appliances. On average, cars in China are about 50% more efficient than in America. Subsidies on energy consumption have also been falling steadily. The IEA calculates that their total value in 2006 was roughly $11 billion, less than half the amount for 2005. That is all the more remarkable given that international oil, coal and natural-gas prices were rising rapidly at the time. Petrol prices, for example, have been going up even faster for Chinese drivers than they have for Americans or Europeans, although they remain low in absolute terms.

To discourage energy- and import-intensive metals-processing, the government raised export duties on iron, steel and related alloys to 25% in December. It also abolished all duty on imports of copper, in the hope that higher imports of finished metal might displace some domestic smelting. And on two previous occasions it has reduced the level of tax rebates that exporters of energy-intensive goods can claim, in some cases down to zero.

There is also a move to diversify away from coal. In big cities (especially Beijing, in preparation for the Olympics), coal-fired heating and power plants are having to be modified to run on natural gas. In the Beijing suburb of Fengtai, where the switch has already taken place, residents recall how the constant dusting of soot from the power plant used to stop them drying clothes outdoors or even opening their windows. Now they can hang out their washing without fear, and sometimes even sit outside.

Nuclear options

The government is planning to increase the country's nuclear generation capacity almost fivefold by 2020. It has ordered new reactors from two of the world's nuclear giants, Areva and Westinghouse, and is also building some of its own design. Power from wind turbines is meant to double by 2010 and grow by a factor of 12 by 2020. Hydropower is supposed almost to triple by the same date. Overall, renewable sources should account for 15% of energy consumption by 2020.

At the same time SEPA is trying to clean up China's coal-fired plants. All new ones are required to install filters in their smokestacks to remove sulphur dioxide, the main cause of acid rain. The biggest existing plants are supposed to retrofit such equipment. Roughly half of China's coal-fired generating capacity is now said to have installed this kind of technology. Between 2000 and 2005 SEPA tripled the fines on polluters. The government has also hired Veolia, a French conglomerate, to build and run model waste-water treatment plants in several big cities.

An open-and-shut case

As the big power plants, factories and coal mines raise their environmental standards, the small ones are meant to shut down altogether. Cyrille Ragoucy, the local head of Lafarge, a cement giant, says that the authorities have encouraged the firm to expand rapidly in the south-west of the country in order to replace the existing stock of old-fashioned, energy-intensive and polluting cement kilns. At the same time

local governments have been ordered to close coal-fired power plants with a capacity of less than 25MW and to bar the construction of any new plants of less than 300MW. The larger scale, along with more modern technology, should improve efficiency dramatically. All told, the government plans to close 50,000MW-worth of small plants by 2010.

The biggest push concerns small coal mines, in which thousands of workers perish every year. They also tend to produce poor-quality coal which generates relatively high levels of pollution when burned. In addition, many of the mines contaminate local water supplies and produce unhealthy, smog-inducing dust in great quantities. So the central government has instructed local officials to shut down any small, dirty and unsafe mines. According to Xinhua, China's state-run news agency, 11,155 such facilities have been closed since the campaign started in 2005. The government wants to eliminate another 4,000 by the end of this year.

But a visit to the province of Shanxi, in the heart of China's coalbelt, reveals why such plans should be taken with a pinch of salt. The Jinhuagong mine, a spokesman explains, is something of a model. It produces 4m tonnes of high-quality coal a year, using the latest British and German machinery. There have been no fatal accidents for two years. The mine's managers are so proud of it that they have opened it up to tourists. Visitors can dress up in jumpsuits and hard hats and descend in a creaking elevator to the coalface 300 metres below the surface. There, a bone-jarring miniature train hauls them a few kilometres deeper into the mine, where they can look at an exhibition on the gradual improvements in safety standards over the years. All the mines in the area that did not comply with safety regulations, the spokesman explains, have been closed.

Yet a taxi driver hailed outside Jinhuagong's gates says he knows of plenty of mines that remain open in defiance of the central government's orders. Waving at Shanxi's bleak landscape of barren, eroded hillsides and jagged valleys, he says: “There's coal everywhere. Wherever there's a road, there's a coalmine.” Sure enough, a half-hour drive through the hills reveals several tiny operations where jerry-rigged conveyor belts carry coal to waiting lorries and workers scatter at the sight of an inquisitive foreigner.

The incentive to continue mining is overwhelming, locals explain. The same shortage of coal that is driving up imports has also pushed up the price. In January power companies had to shut several coal-fired plants because they did not have enough fuel to go round. The government has withdrawn all export credits on coal and imposed taxes instead, but supply continues to fall short of demand. Moreover, the officials who are responsible for closing mines are often shareholders in them too. And even if they have no financial interest in them, they still view economic growth and job creation as the chief gauge of their success.

The intentions are good

SEPA did come up with an alternative yardstick, dubbed “green GDP” and intended as a joint measure of both environmental and economic stewardship. But sceptical officials rebelled, so the central government quietly shelved the scheme. Regulators concede that poor enforcement is undermining most of their attempts to improve the state of the environment. SEPA has less than a tenth of the staff of its American equivalent to police a country with over four times the population. To enforce its rulings, it relies on local bureaucrats over whom it has no authority. “Overall, environmental efforts have lacked effectiveness and efficiency, largely as a result of an implementation gap,” as the OECD's report puts it.

That is why Jim Brock, a consultant to domestic and foreign energy firms in China, thinks it is unlikely that many small power plants are in fact being closed down. Even those plants that have the equipment to remove sulphur dioxide from their flue gas often do not bother, officials concede, because the process uses power and so reduces profits. At any rate, emissions are not yet falling fast enough to meet the government's targets.

What is more, the proliferation of coal-fired plants is swamping the growth in renewable power. Some 90% of the power plants built in 2006 run on coal, the IEA notes, against 70% of those built in 2000. And heavy industry such as steelmaking continues to grow, says Rui Susheng, the director of the China Coal Society, despite the government's attempts to curb it.

All this means that the government is falling short of its energy-efficiency targets. In 2006 China's energy intensity (the ratio of energy consumption to economic output) fell by 1.2%, well short of the government's goal of 4% a year until 2010. That was an improvement on the previous few years, when it

actually rose. Yet the impression remains that the government is fighting a losing battle.

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The perils of abundance

Mar 13th 2008
From The Economist print edition

China must learn to do more with less

AP

The environment gets them going

THE irony of China's struggle with energy intensity is that until recently its policymakers did not even have to try to encourage sparing use of resources: it just happened naturally. By the late 1970s, thanks to the party's ill-conceived industrialisation drive during the era of central planning, the country found itself saddled with lots of inefficient, loss-making, power-guzzling factories. As the reforms launched by Deng gathered speed, many of these cast-iron albatrosses were either forced to operate more efficiently or closed down. At the same time lots of light manufacturing plants sprang up. The growing export sector was much more profitable and used far less power than the heavy industry it was replacing, so China's energy intensity began to fall.

Indeed, it kept on falling consistently and dramatically for a quarter of a century. Between 1978 and 2000 it dropped by two-thirds, according to a recent paper by Daniel Rosen and Trevor Houser, respectively of the Peterson Institute for International Economics and City College of New York. But in 2002 this virtuous cycle went into reverse. Energy consumption, which had been growing at half the pace of the economy as a whole, suddenly began to grow one-and-a-half times as fast. An increase in the pace of economic growth compounded the effect.

The authorities were taken by surprise, and so were the global commodities markets. Analysts instantly increased their estimates for Chinese economic growth, commodity consumption and imports. Mining and oil firms, which had been investing on the assumption that sales would grow slowly and steadily, suddenly found themselves struggling to cope with China's ballooning demand. The resulting rapid inflation continues to this day.

In retrospect, however, the surge in energy consumption is easily explained. It stems from the spectacular renaissance of heavy industry. Firms such as Shougang had been investing in steel mills, cement plants, aluminium smelters and the like without let-up. Between 2000 and 2005 the share of metal-processing in national output doubled and that of petrochemicals rose by two-thirds. Cement, glass, paper and other energy-intensive industries also boomed. Although the new factories tend to use fewer resources and less energy per unit of output than most of China's older stock, the surge in their number has dwarfed the gains in efficiency.

Economists offer two opposing, although not entirely incompatible, reasons for this unexpected flowering of heavy industry. Some believe that China has reached a stage in its development when labour becomes relatively scarce and growth begins to rely more heavily on investment. At this turning point, the theory runs, shortages of labour lead to rising wages and so to higher incomes. Consumers with more spending power, in turn, start to buy homes, cars and televisions, gobbling up huge volumes of natural resources in the process.

Last year, in a report funded by Rio Tinto, Ross Garnaut and Ligang Song of the Australian National University argued that in countries where income per person has passed $2,000, as it did in China in 2006, demand for natural resources begins to grow at a much faster pace than previously, and continues to do so until income per person reaches roughly $20,000. That pattern has been particularly pronounced in Japan and South Korea, they argue, because of high levels of investment, exports and urbanisation. China also has high and rising levels of all three, so the authors expect its consumption of natural resources to follow a similar path.

“The increase in China's demand for metals during the next two decades may be comparable to the total demand from the industrialised world today,” they conclude. Prices, they add, “will remain on average

much higher in real terms than they were during the last quarter of the 20th century." Mr Albanese, Rio Tinto's boss, agrees. China's appetite for his firm's wares may not keep on jumping by a fifth or a quarter each year, he says, but he expects growth to remain in double digits. There could always be political or economic hiccups, but the more he and his staff look at China, the more confident they are that growth in demand will remain high.

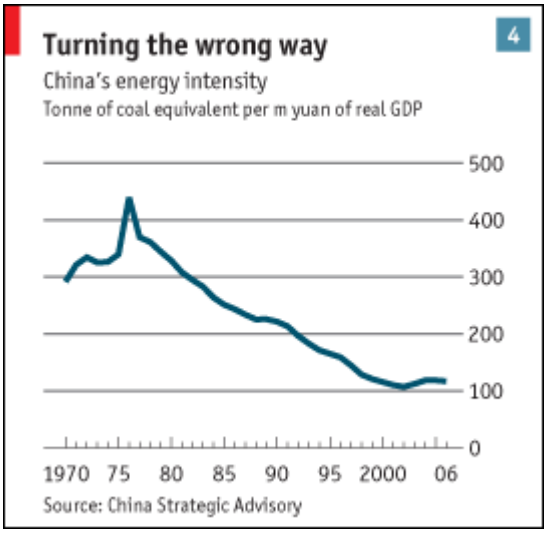
A capital mess

Messrs Rosen and Houser contend that the boom in heavy industry is a product mainly of poor regulation rather than of inexorable demographic forces. They believe that China's development is becoming more capital-intensive not so much because labour is getting scarce but because capital is too abundant.

Local officials, keen to register impressive increases in output that might earn them promotion, lean on state-owned banks to lend to state-owned firms for investment in heavy industry. The banks can lend cheaply because the government sets the interest they pay to depositors at a very low rate (in real terms, it is currently negative). The industrial firms, in turn, seldom pay dividends, usually receive land free of charge and often ignore environmental regulations that push up costs. All this makes them much more profitable than less privileged companies, providing further funds for investment.

China's rapid transformation from a big importer of steel to a big exporter suggests that global production is moving there to take advantage of the exceptionally favourable investment climate. In other words, much of China's industrial bonanza exists only thanks to subsidies paid by its frugal households and its long-suffering taxpayers.

If this argument is correct, it is heartening because it suggests a clear remedy: an overhaul of the financial sector. Indeed, such reforms are all the more necessary if Messrs Garnaut and Song are right that demography is helping to spur the expansion of heavy industry. To their credit, the authorities are already trying to rein in overgenerous loan officers and overenthusiastic industrialists. They have repeatedly raised interest rates and reserve requirements and instructed banks to steer clear of dubious industrial projects. Last year, for the first time, they started demanding dividends from some state-owned enterprises, albeit on a modest scale.



But such measures, like environmental controls, must be implemented by officials whose heart may not be in them because their first priority is economic growth, Moreover, they are essentially administrative in nature and do little to tackle the underlying problem: that capital is too cheap and that Chinese banks are not very good at allocating it. Even the central government has repeatedly shied away from root-and-branch reform of China's opaque financial sector.

The vast supply chain that stretches from the pot-holed streets of Lubumbashi and the fly-blown bush of the Pilbara to China's proliferating steel mills and cement plants is raising all sorts of concerns as it cranks into action. Governments around the world are struggling to adapt to the scale and pace of the change. But the biggest strains, and the greatest risk of serious damage, are concentrated at the end of the chain: in China itself.

So far, China's leaders have managed to keep the tensions brought on by rapid development under control. But doing so has not been easy, especially given their country's unwieldy and undemocratic system of government. Now China is importing even more environmental and social pressures along with the raw materials with which it feeds its hungry industries. Long before the world runs short of the commodities China needs, those pressures are likely to come to a head.

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Business in Russia

The meaning of Norilsk

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Illustration by David Simonds

How a takeover battle provides a test case for Russian capitalism

THE drama surrounding Norilsk Nickel, the world's largest nickel producer, has all the elements of an airport thriller: billionaire oligarchs invading the French resort of Courchevel; models flown in from Moscow; wads of cash flying like confetti; all-night discos, magnums of champagne and buckets of caviar; and the whole thing topped off with a police raid. The scene then shifts to the Arctic city of Norilsk, built by slave labour under Stalin, and the nickel giant that generated all this wealth, now at the centre of a takeover battle. The Norilsk saga is being closely watched because it is a test of how the rules of business in Russia are changing.

Norilsk Nickel was one of many firms sold at a knock-down price in the 1990s in Russia's infamous loans-for-shares privatisation scheme. Vladimir Potanin, one of the original set of Yeltsin-era oligarchs, was partly responsible for the scheme, which gave him and Mikhail Prokhorov, his young business partner, control of the firm for a song. The privatisation was indefensible from almost any point of view—but it worked. Today Norilsk Nickel is more transparent, efficient and profitable than it has ever been. It has a proper board of directors, professional managers and is worth nearly $60 billion.

The pair made a good team: Mr Prokhorov ran the business and Mr Potanin handled the politics. Between them they owned 54% of the firm. Tall, handsome and outrageously rich, Mr Prokhorov became Russia's most eligible bachelor. He worked hard, but he played even harder. In January 2007 he was arrested by French police after his antics in Courchevel on suspicion of running a prostitution ring, but a few days later he was released without charge. Nobody can be sure if he was set up or if his outrageous behaviour simply went too far. “Senior people in the Kremlin told Mr Potanin to tell his friend to tone it down, but Prokhorov would not listen,” says a businessman familiar with the situation. After the incident Mr Potanin, who holidayed with Mr Prokhorov in Courchevel, distanced himself from his partner and condemned his behaviour.

Their split was, perhaps, inevitable. Mr Prokhorov ran the show, but all the credit went to Mr Potanin. Having transformed Norilsk Nickel, Mr Prokhorov faced the far less exciting prospect of having to run it. So he made a symbolic offer to sell his 25% stake to Mr Potanin for $15 billion. When Mr Potanin refused (some say he could not raise the money, others claim he did not even try), Mr Prokhorov turned to Oleg Deripaska, Russia's richest man and one of the most aggressive oligarchs. Mr Deripaska owns 66% of privately held RUSAL, the largest aluminium producer in the world. For the stake in Norilsk, he has offered Mr Prokhorov 11% of RUSAL's stock and an estimated $6 billion in cash (the exact sum is

unknown). And if RUSAL does not go ahead with its planned flotation within the next year, Mr Deripaska has promised to buy Mr Prokhorov's stake.

The deal could reshape Russia's metals industry. RUSAL sees the purchase of Mr Prokhorov's 25% stake in Norilsk as the first step towards a full merger or takeover, and has loudly declared its intentions to the media, though not to Norilsk itself. Alexander Bulygin, RUSAL's boss, justifies the takeover on the basis that it would enable his firm to diversify into other metals, in keeping with a global trend for such deals.

Even if the industrial logic is sound, however, Norilsk Nickel's managers are irked that RUSAL has not made a formal approach and has not explained how it could possibly execute a merger. Given that RUSAL is a private company registered in Jersey, Norilsk's minority investors are unlikely to be interested in a share-swap. And RUSAL does not have the cash to buy them out: it is thought to be heavily indebted, even before borrowing $4.5 billion to help it pay for Mr Prokhorov's stake. The worry in Mr Potanin's camp is that RUSAL has its eye on Norilsk's cashflow and plans to sneak an extra person or two onto its board of directors, install new management and then milk the company. Many Russian oligarchs did this in the 1990s to the detriment of minority investors.

The plot thickens

So Mr Potanin has brought in another metals magnate, Alisher Usmanov, who owns iron-ore mines and has links to Gazprom, Russia's state-controlled gas giant. Mr Usmanov's private company, Gazmetall, has made a formal approach, through a foreign bank, to Norilsk. A merger with Gazmetall would certainly make it harder for RUSAL to take over Norilsk. But it could also pave the way for a merger of all three firms.

The management of Norilsk Nickel stresses that its job is to act in the interest of all its shareholders. So far it has managed to resist the pressure from its two biggest shareholders. And it has asked its minority investors to attend a shareholder meeting on April 8th and to vote in a co-ordinated way in order to protect their interests. What will happen before or after that date is hard to predict. But already the Norilsk saga holds some lessons.

The most striking thing about the affair is that a set of business tycoons have, so far, behaved in a way that is a lot more civilised than anything seen from the Russian state. When state firms want a private asset, they send in the tax police, the security services and a few health and safety inspectors, before making an offer. Here, big private firms are dealing with each other mostly using bankers and lawyers.

Admittedly, all of the oligarchs squabbling over Norilsk have powerful friends in the Kremlin, which may be why it has not sided with any of them. Yet if Mr Prokhorov manages to sell his stake in Norilsk, it will strengthen property rights. He will be almost the only tycoon to have cashed out assets privatised in the 1990s. To date, the Kremlin has treated oligarchs like renters rather than owners and no significant sale has been possible without its blessing, even when no foreigners are involved.

The Kremlin certainly wishes to see a large national mining and metals champion, but it does not seem to mind about its exact form. Many combinations are possible and the very fact that the outcome is unknown, and is not being dictated by the state, is a sign of progress.

What matters, in the end, is not just the outcome, but also how it comes about. It is heartening to see a Russian company with professional managers who no longer treat minority shareholders as just an obstacle. When the rule of law is non-existent and the Kremlin often acts like a gangster, it falls to business leaders to work out the rules and abide by them. If they can manage this, they will take Russia forward. If they fail, they will reinforce the worst clichés about its business practices.

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Media

Mogul v mogul

Mar 13th 2008 | NEW YORK
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Barry Diller and John Malone have their day in court

THE divorce of a celebrity couple could hardly be juicier than the corporate battle that began on March 10th in a Delaware court. Actually, the protagonists are a celebrity couple, of sorts. One is Barry Diller, an engaging former Hollywood studio boss, who revels in dealing with the media and has turned himself into an internet tycoon; the other, John Malone, was once Mr Diller's biggest fan and is a hard-nosed, limelight-avoiding, tax-hating media boss who first made his fortune in cable television, but has since acquired a taste for fighting with his fellow moguls.

At issue in court is Mr Diller's plan to break the internet-media conglomerate he runs, IAC/InterActive Corp, into five pieces. Mr Malone's Liberty Media has a 30% shareholding in IAC and 62% of the votes. The question is, having formally delegated control of those votes to Mr Diller in 2005, can Mr Malone take them back now he is at odds with his former protégé? Mr Malone, the first witness to testify, accused Mr Diller, who has a 3.8% stake in the firm, of breaching his stewardship obligations and running IAC as if he owned it.

Mr Diller's supporters say Mr Malone's claim—that the break-up is an attempt to disenfranchise him—is spurious, and that what Mr Malone really wants is to negotiate an exit that favours Liberty at the expense of other shareholders. In particular, Mr Malone is said to want IAC's Home Shopping Network as his price for going away.

Mr Malone accused Mr Diller of “aggressive” use of the corporate jet, and said that his pay “raised eyebrows”. What is clear is that after initially making a fortune for IAC's shareholders, including Mr Malone, Mr Diller has in recent years profited handsomely himself, even as IAC's shares have plunged. Having peaked at over $80 in 2004, IAC shares now trade below $20, though that is still higher than when Mr Diller took charge. Corporate-governance activists, whom Mr Diller loves to criticise, also describe him as overpaid by any measure: he took home $295m in 2006.

The days when Mr Diller could proudly claim to be the only old media boss to “get” the internet are long gone. The portfolio of internet brands he bought, from mortgage-market-exposed Lending Tree to eBay-exposed TicketMaster and Google-battered search engine Ask.com, increasingly seem off the pace, having largely missed out on the social-networking boom. The only cool thing about Mr Diller these days is the “Diller-Plex”, IAC's funky new Manhattan office, designed by Frank Gehry.

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Yahoo!'s options

Deconstructing Jerry

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A subtle gesture by Yahoo! allows Microsoft to keep things polite, for now

Reuters

But he is not happy about selling

THIRTEEN years ago a great many people first saw the internet through "Jerry's Guide to the World Wide Web". It was a list of cool websites, maintained by Jerry Yang and David Filo, two friends who really should have been studying for their graduate programme in electrical engineering at Stanford University. Out of truancy came a hit. Never too serious, they renamed their list Yahoo!, for "Yet Another Hierarchical Officious Oracle", and soon were smiling for the cameras through piles of old pizza boxes. They personified everything young and fun about the fledgling web, a loveable antidote to that darker technological force, Microsoft, which was stifling the first popular web browser, Netscape, just as Yahoo! went public in 1996.

But times change. Mr Yang hired one chief executive to guide Yahoo! through its early growth, then another to manage its crisis during the dotcom bust. Another pair of truant Stanford graduate students, Sergey Brin and Larry Page, invented Google, a search engine that Yahoo! chose not to buy, mistaking search for a feature of web portals rather than a new approach to surfing. Yahoo! floundered, and last June Mr Yang, who had remained on its board, took over as chief executive to try to rescue his creation rather as Steve Jobs, Mr Yang's idol, came back to save Apple.

But there was no romance in it any more. Yahoo!'s morale was collapsing and its best people were defecting. Far from smiling through pizza boxes, Mr Yang was now being harangued in Congress for giving the Chinese government information that led to the jailing of two dissidents, one of whose grieving mothers sat behind Mr Yang as he testified. In online advertising, Yahoo! kept falling behind Google, and shareholders continued to suffer. Last month Microsoft offered to put them out of their misery, offering $44.6 billion in cash and shares for the company.

Mr Yang's first instinct was to look around for absolutely any alternative. But as a fiduciary, he had to look out for his shareholders, some of whom started suing. One option was to make a deal with News Corp, a media giant that owns the largest online social network, MySpace. News Corp would swap MySpace for a large stake in Yahoo!, which has notably failed to build its own social network. But News Corp is busy digesting Dow Jones, an old-media acquisition, and Rupert Murdoch, its boss, this week said that he had no interest in getting into a fight with Microsoft, which has more money.

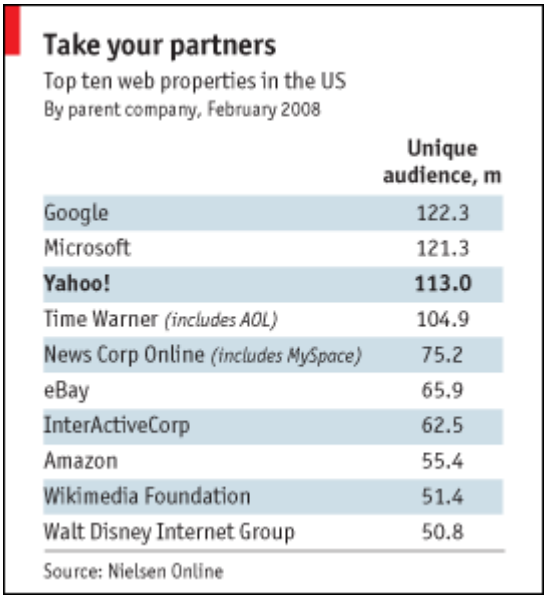
Another option is to get help from Time Warner, another media giant, which could fold its web portal, AOL, into Yahoo!, also in return for a big stake in the firm. Yahoo! and AOL are similar in many ways: both are strong in web mail, instant messaging and online display-advertising. And both are long in the tooth, with AOL fading since its glory days in the early 1990s and Yahoo! following suit a decade later.

One advantage of such a combination is that Google, which owns a 5% stake in AOL, may be able to help. Perhaps surprisingly, Yahoo! considers Google more friend than foe during the negotiations. Its founders have an alma mater and much else in common with Yahoo!'s, and both regard Microsoft as the real enemy. Google at first tried to spread the idea that a Microsoft-Yahoo! combination would raise antitrust concerns, which rang hollow given that Google itself was facing an antitrust investigation in Europe over its acquisition of DoubleClick, a company that could make it as powerful in display advertising as is it in search ads. (On March 11th

European regulators cleared the deal.)

The overwhelming problem for Mr Yang is that none of these paths would obviously yield more money to his shareholders than Microsoft's offer. Microsoft has bid cash and shares, whereas both MySpace and AOL are subsidiaries without a public market. How would shareholders compare their value with Microsoft's concrete offer?

Mr Yang is an amiable character who hates aggression in management as much as in takeovers. So he made a gesture to Microsoft this week to avert hostility. Yahoo! had a deadline of March 14th for shareholders to nominate directors to be voted on at the annual meeting, which must be held between now and July. This would have forced Microsoft to put up its own slate of directors in opposition to the present batch, and thus to fire the first salvo in a proxy battle. But Yahoo! postponed the deadline, buying more time and keeping Microsoft officially friendly, for now.



Take your partners

Top ten web properties in the US
By parent company, February 2008

	Unique audience, m
Google	122.3
Microsoft	121.3
Yahoo!	**113.0**
Time Warner *(includes AOL)*	104.9
News Corp Online *(includes MySpace)*	75.2
eBay	65.9
InterActiveCorp	62.5
Amazon	55.4
Wikimedia Foundation	51.4
Walt Disney Internet Group	50.8

Source: Nielsen Online

There are worse fates for Mr Yang than selling. He is 39, recently became a father, and he has a promising golf game. He is reluctant to cave in to Microsoft, but he probably has no choice, given his duty to his shareholders. He needs to explore all the alternatives and put up a bit of a struggle first, if only for the sake of his own pride. As any parent knows, the most painful part is always letting go.

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Industry in China

Where is everybody?

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Manufacturers struggle in southern China's industrial belt

AT FIRST, the managers of the factories spread throughout Guangdong province thought the lack of returning workers after the Chinese New Year break in early February was merely because they had been delayed by the huge blizzard that disrupted rail and power lines, and left roads impassable. But now that the mess has now been cleaned up, it is clear that the vast annual migration of around 20m people that has fuelled the manufacturing boom in southern China over the past two decades is beginning to diminish.

The Guangdong Labour Ministry reckons 11% of the workers did not return after the holiday; other estimates are as high as 30%. Whatever the precise number, many factories are reeling. Wages were already rising; now they will surely go up further, adding to surging costs for credit, materials, energy, environmental compliance and health care. Meanwhile, revenues are falling due to slowing demand from America and a reduction, following pressure from other countries, in China's complex system of export subsidies.

A survey of conditions in southern China conducted in the aftermath of the Chinese New Year, covering 162 members of the Federation of Hong Kong Industries, produced reams of gloomy figures. Members estimated 10-20% of the 70,000 factories in Guangdong province had closed in the past year, and expected a similar number to close within the next two years. Two-thirds of those polled said they were unsure whether to invest more in the region; one-third planned to cut investment. Only one respondent was optimistic.

To some extent the upheaval in southern China follows a government plan to force dirty, low-paying industries out of business or into poorer interior regions that have so far missed out on the country's growing industrial wealth. The hope is that the gaps in Guangdong will be filled by factories producing more sophisticated, high-value products that are cleaner and less energy-intensive to produce. There are signs that this is indeed happening.

Factories are opening up in China's interior, providing opportunities for those in rural areas to find employment closer to home, rather than having to leave their families for an entire year. This may explain the reduced flow of migrant workers. At the same time, discriminating industrial parks are popping up in Guangdong and Suzhou, among other places, that will only permit factories producing sophisticated electronics and medical equipment. The factories in deepest trouble are said to be in low-cost, low-skill areas: toys, plastics, shoes, clothing and so on. Many are sweatshops with poor working conditions.

Firms that provide relatively high wages and good working conditions do not seem to have problems attracting employees. Nike's sneaker factory in Dongguang, one of the grimier sections of Guangdong, has 27,000 workers, including 4,500 that have returned over the past year and 40% who have been around for at least three years. The workers receive 1,400 yuan a month ($200), well above the minimum wage, receive subsidised food and (for the 7,500 living inside the factory) clean dormitories. Nike is not competing for the low end of the market: shoes produced its is Dongguang factory can cost as much as $185 a pair.

But Nike has been steadily spreading manufacturing from southern China to the rest of the country, and the rest of South-East Asia. Indeed, the idea of shifting away from China seems to be gaining adherents. A study by Booz Allen Hamilton, a consultancy, on behalf of the American Chamber of Commerce in Shanghai, says more than half of foreign firms believe China is losing its edge over other low-cost Asia countries, and 17% intend to relocate.

This shift will be a good thing, as production shifts to Bangladesh, Indonesia, Malaysia and even Africa,

spreading wealth and deepening manufacturing skills. Whereas China was once desperate to grow through exports, it is now developing its own domestic economy and has other ways to thrive beyond merely producing cheap goods. But these shifts are at the very least disruptive. Hundreds of thousands, if not millions, of unskilled workers still depend on southern China's low-cost factories for their livelihoods.

And as the rusted hulks of manufacturing plants throughout the Western world attest, the transition to higher-value products can be difficult. Clement Chen, the chairman of the Federation of Hong Kong Industries, says the Chinese government is understandably clamping down on lots of dirty industries—leather tanning, dyeing, finishing, electroplating, and the like—but that this can disrupt the broader manufacturing supply chain, including industries China wants to develop. Business environments, like ecosystems, can be fragile—and once lost, competitive advantage can be hard, if not impossible, to regain.

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Business in emerging economies

The stay-at-home giants

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Not all of the developing world's most successful companies are globalising

AFP

Inside the dynamo at Amul

ISRAEL is a “powerhouse of agricultural technology”, says Abraham Goren of Elbit Imaging (EI), an Israeli multinational. The country's cows can produce as much as 37 litres of milk a day. In India, by contrast, cows yield just seven litres. Spotting an opportunity, EI is going into the Indian dairy business. It will import 10,000 cows and supply fortified and flavoured milk to supermarkets and other buyers.

So will EI lap up India's milk market? Not necessarily. As the *Times of India* points out, its cows will ruminate less than 100 miles from the headquarters of a formidable local producer—the Gujarat Co-operative Milk Marketing Federation, otherwise known as Amul. This farmers' co-operative spans 2.6m members, collects 6.5m litres of milk a day, and boasts one of the longest-running and best-loved advertising campaigns in India. It has already shown “immense resilience” in the face of multinational competition, says Arindam Bhattacharya of the Boston Consulting Group (BCG). Its ice-cream business survived the arrival of Unilever; its chocolate milk has thrived despite Nestlé.

Indeed, Amul is one of 50 firms—from China, India, Brazil, Russia and six other emerging economies—that BCG has anointed as “local dynamos”. They are prospering in their home market, are fending off multinational rivals, and are not focused on expanding abroad. BCG discovered many of these firms while drawing up its “global challengers” list of multinationals from the developing world. The companies that were venturing abroad most eagerly, it discovered, were not necessarily the most successful at home.

Emerging economies are still prey to what Harvard's Dani Rodrik has called “export fetishism”. International success remains a firm's proudest boast, and with good reason: economists have shown that exporters are typically bigger, more efficient and pay better than their more parochial rivals. “Exporters are better” was the crisp verdict of a recent review of the data.

Countries like India and Brazil were, after all, once secluded backwaters fenced off by high tariffs. Prominent firms idled along on government favours and captive markets. In that era, exporting was a truer test of a company's worth. But as such countries have opened up, their home markets have become more trying places. Withstanding the onslaught of foreign firms on home soil may be as impressive a feat as beating them in global markets.

BCG describes some of the ways that feat has been accomplished. Of its 50 dynamos, 41 are in consumer businesses, where they can exploit a more intimate understanding of their compatriots' tastes. It gives the example of Gol, a Brazilian budget airline, which bet that its cash-strapped customers would sacrifice convenience and speed for price. Many Gol planes therefore depart at odd hours and make several hops to out-of-the-way locations, rather than flying directly.

Similarly astute was India's Titan Industries, which has increased its share of India's wristwatch market despite the entry of foreign brands such as Timex and Swatch. It understood that Indians, who expect a good price even for old newspapers, do not throw their watches away lightly, and has over 700 after-sales centres that will replace straps and batteries.

Exporters tend to be more capital-intensive than their home-bound peers; they also rely more on skilled labour. Many local dynamos, conversely, take full advantage of the cheap workforce at their disposal. Focus Media, China's biggest “out of home” advertising company, gets messages out on flat-panel displays in 85,000 locations around the country. Those displays could be linked and reprogrammed electronically, but that might fall foul of broadcast regulations. So instead the firm's fleet of workers on bicycles replace the displays' discs and flash-cards by hand.

The list of multinationals resisted or repelled by these dynamos includes some of the world's biggest names: eBay and Google in China; Wal-Mart in Mexico; SAP in Brazil. But Mr Goren of EI is not too worried about Amul. The market is big enough for everybody, he insists. Nothing, then, for either company to cry about.

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Law firms

Legal problems

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Trouble for lawyers as deals dry up

AS LEAKED e-mails go, it sounds harmless enough. But when a senior partner at Clifford Chance, one of the world's biggest law firms, sent a memo on February 25th warning staff not to abuse its free-taxi policy, he inadvertently sent a bleak message about the outlook for the legal industry, which has thrived on the frantic dealmaking of the past few years. Free taxis are a telling indicator of prosperity at big law firms, and an essential perk for lawyers pulling all-night stints at the negotiating table. Limiting this perk signals a difficult time ahead, with fewer deals and tighter budgets.

Indeed, parts of the industry are already beginning to see the kind of layoffs last glimpsed during the slowdown that followed the dotcom crash. Cadwalader, Wickersham & Taft, an American firm, recently made 35 associates redundant; Dechert, another American law firm, laid off 13. For both firms, the seizing up of the credit markets means there is much less demand for the specialist finance practices that have become so profitable in the past two or three years. Dechert's redundancies came in its finance and property group; Cadwalader's were in structured finance. “We will we suffer the pain with our clients,” says Rodgin Cohen, the chairman of Sullivan & Cromwell, an international law firm based in New York.

But amid the gloom, many lawyers at British and American firms are quietly confident that things are unlikely to get much worse. Moving into new markets—such as Central Europe, the Middle East and East Asia—has helped to make Anglo-Saxon law firms the biggest in the world. Rising energy prices have boosted the volume and value of deals in these regions, even as things have slowed down at home. English transactional law has become the deal guideline of choice in Moscow and elsewhere, allowing firms with strong London bases and plenty of British-qualified lawyers to expand into new jurisdictions where demand outstrips supply.

Firms that are not already in these promising new markets are fast moving into them as the clouds gather in America. Several American law firms, including Latham & Watkins and Skadden, Arps, Slate, Meagher & Flom, recently exceeded $2 billion in annual revenue for the first time. They celebrated by setting up fancy new offices in the Middle East and China respectively. Another American firm, White & Case, has been diversifying in this way for many years, and last month it opened its first office in Romania. Operating in places like Moscow, Central Europe and Brazil “creates a natural hedge and keeps momentum going,” says Hugh Verrier, the firm's chairman.

Back home, restructuring and insolvency work provides another cushion against hard times. In Britain the turmoil surrounding Northern Rock, a cash-strapped bank, has paid for many an associate's late-night taxi. Freshfields Bruckhaus Deringer, a London law firm, is said to have earned some £10m ($20m) for its advice to the stricken bank; Slaughter and May, another law firm, is thought to have made about £3m advising the Treasury on Northern Rock's subsequent nationalisation. Rivals such as Clifford Chance and Linklaters have found work acting for other actors in the drama. As more companies run into trouble this year and next, as seems inevitable, there will be plenty of work for lawyers.

Nevertheless, David Ereira, a banking lawyer at Linklaters who specialises in restructuring, says demand remains reasonably robust, but that growth will slow from the double-digit rates of recent years to less than 10% in 2008-2009. International expansion and diversified practice groups will not entirely insulate global law firms from a slowdown, but will help them weather the storm. Job losses are most likely at firms that lack such protection. Junior lawyers may have to start taking the bus home from work, but partners should have little trouble making the payments on the Porsche.

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Industrial relations

On strike, virtually

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French workers embrace new forms of protest that stop short of striking

VISITORS to France have always had to watch out for strikes that might disrupt their holidays or business trips. So far this year air-traffic controllers, taxi drivers and (this week) dockers have walked out. Last November it was the railwaymen. *Plus ça change*, you might think. But the pattern of French industrial action is changing. A study commissioned by the labour ministry found that the number of days lost to strikes has fallen since the late 1990s—yet the number of French firms hit by industrial disputes went up by roughly half between 1998 and 2004.

That is because workers now favour short, sharp walkouts lasting less than a day, and these fail to register in the official figures. They inflict the maximum disruption with the minimum loss of workers' pay. In a world of just-in-time production, a just-in-time walkout, or a union meeting that strays beyond the break, can wreak havoc and put pressure on management. Workers at Toray Plastics Europe, in south-east France, won a dispute this way last month.

Technology is also transforming traditional industrial disputes. Blogs are being used to draw outside attention to disputes within companies and win support from consumers, politicians and the local community. Workers at a subsidiary of Fnac, a retailer, used a blog to rally support and gather evidence for a redundancy protest, which they then took to employment tribunals. Workers at a Savoy furniture firm used a blog in a campaign that won them an improved redundancy offer. At La Redoute, another store chain, workers have set up a blog called “On redoute La Redoute” (we fear La Redoute) to stay informed about possible closures of branches and call centres, and to organise resistance.

The internet allows expressions of discontent to be aggregated, giving workers the opportunity to stage protests without actually going on strike. The most dramatic example came last September in Italy, at the local arm of IBM. About 2,000 employees of the computer giant—logging on from home to dodge legal problems—staged a virtual protest against a new pay settlement at IBM's corporate campus in Second Life, an online virtual world. A month later the head of IBM Italy resigned and the RSU union agreed on a new pay deal. This innovative use of the internet was recognised with an award at the Forum Netxplorateur, a conference held in Paris in February. The award was presented by the president of Microsoft France.

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Face value

Woman of steel

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Emma Marcegaglia has shown her mettle in the family business. Now she will be tested leading Italy's bosses' club

AFP

FROM the windows of her office in Gazoldo degli Ippoliti, a small town deep in the countryside at the eastern end of the Lombardy plain, Emma Marcegaglia looks out across an expanse of factory-roof large enough to cover sixty football pitches. In the noisy factory below, workers transform steel coils into the tubes, strips, bars and plates needed in an enormous range of products, from broom-handles and door hinges to food-processing machinery, refrigerators, radiators and much more. Ms Marcegaglia is managing director and finance chief of Marcegaglia, the European leader in steel transformation that was founded by her father, Steno, in 1959.

Ms Marcegaglia regularly dons a blue hard-hat to visit the shop floor. But she will soon be spending less time among the cold-rolling mills, annealing furnaces and welding lines of the firm's numerous factories. As *The Economist* went to press, the executive board of Confindustria, Italy's employers' confederation, was due to propose Ms Marcegaglia as its chairman, succeeding Luca di Montezemolo, himself the chairman of Fiat and president of Ferrari. When a small group of businessmen sounded out Confindustria's members earlier this year they learnt that Ms Marcegaglia, the confederation's deputy chairman, was overwhelmingly the members' choice for the top job. She will be the first woman to hold this position and, at 42, the second-youngest person to head an organisation that has far more clout than similar bodies in other European countries.

A prominent figure on the Italian business scene for many years, Ms Marcegaglia is ideally qualified to be the official face of corporate Italy, having acted as chairman of Italy's young entrepreneurs' club from 1996 until 2000 and as deputy chairman of Confindustria since May 2004. Her appointment marks the passing of the torch from an older generation of grey-haired Italian bosses, and she will bring a more globalised perspective to the job than her predecessors. But her elevation is also, in part, a recognition of the importance of companies like Marcegaglia. It was one of many new firms that emerged during Italy's economic miracle in the 1960s, and many of its Italian factories lie east of Milan, reflecting how the country's industrial centre of gravity has shifted away from its northwest corner. “Italy is not just design, fashion and food, but mechanical engineering as well,” says Ms Marcegaglia. “Germany and Italy are now Europe's only true manufacturing countries.” She is determined that Italy should retain its manufacturing base.

Deindustrialisation is not inevitable, she insists; opportunities still exist for manufacturing, despite stiff competition from countries with lower labour costs. But avoiding industrial decline and realising opportunities requires firms to take action, by moving upmarket into high-value products, she says. Politicians also need to act: Italy's public sector is too large and too inefficient, its labour market too rigid and its infrastructure weak, she complains. “These weights must be lifted from our shoulders,” she says—

just the sort of thing Confindustria's members like to hear. As its deputy chairman, she has attacked the energy sector as a protected, coddled industry that places a burden on manufacturing and needs a sharp dose of competition.

Ms Marcegaglia's own family business shows what is possible. Its turnover has grown at an annual rate of almost 20% over the past five years. In 2007 the steel group, which also has interests in tourism and energy that account for some 5% of turnover, had revenues of about €4.2 billion ($5.7 billion) and it is expected to report a doubling of net profits to around €125m. Of its 100 Italian rivals from 40 years ago only eight remain, and Marcegaglia is the biggest of the bunch by far. Its strategy depends on economies of scale, buying steel coils in bulk and turning them into tens of thousands of different products. It has stakes in steelmakers, which allow it to source one-third of its requirements at production cost, while giving it the freedom to buy from other sources too (the rising price of Chinese steel prompted the firm to look closer to home, in places like Libya). And diversification across many product categories and markets enables the firm to spread risk. It manufactures in Britain and America, is expanding its large plants in Brazil and Poland, and will soon announce a big project in Yangzhou in eastern China that will make a range of tubes, mainly for Chinese customers.

Annealed by globalisation

Ms Marcegaglia has a similarly global outlook. After taking a degree in business economics in Milan she studied at New York University's Stern School, and says living in the city was a formative experience. “My father was worried that I would never return to Italy, and I did have difficulty adapting when I got back,” she recalls. But she has since demonstrated that traditional Italian family-run firms can be compatible with modern, global capitalism—and need not be afraid of it. “If a firm can grow strongly using its own cashflow and good relations with its banks then it has no need to look outside for more capital,” she says. Family owners take the long view, she adds, whereas stockmarkets focus on the short term—again, a reassuring message for Confindustria's members.

But not all of Ms Marcegaglia's views will be so warmly received. She embodies a dynamic, vibrant form of Italian capitalism that accepts that globalisation is inevitable and embraces it. There is no magic wand that can be waved to make it go away, she says. As she continues to champion market liberalisation and competition, her resolve will be tested by the many Italian businessmen who continue to call for greater protection from foreign competition. When she takes over in May her priority will be to encourage other Italian companies to follow Marcegaglia's example and treat globalisation as an opportunity rather than a threat.

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Economics and the rule of law

Order in the jungle

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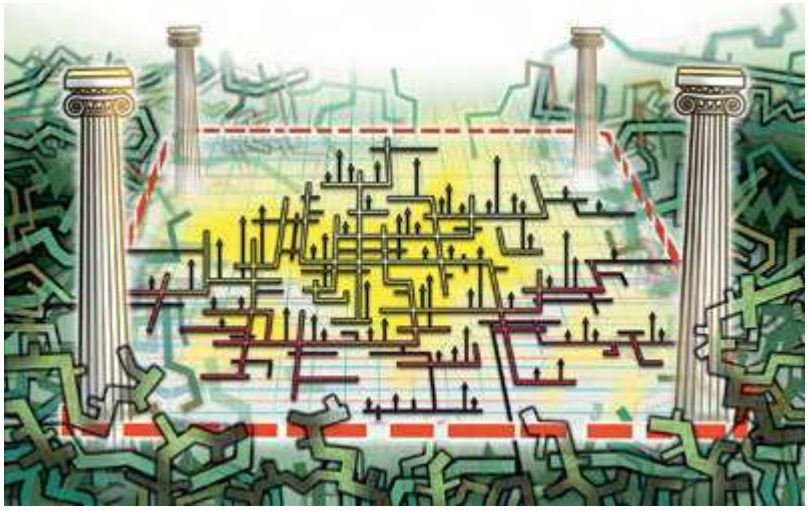
JAC



The rule of law has become a big idea in economics. But it has had its difficulties

“AM I the only economist guilty of using the term [rule of law] without having a good fix on what it really means?” asks Dani Rodrik of Harvard University. “Well, maybe the first one to confess to it.”

The rule of law is usually thought of as a political or legal matter. The world's newest country, Kosovo, says its priority is to improve the rule of law in order to reduce corruption and build up the state. But in the past ten years the rule of law has become important in economics too. Indeed, it has become the motherhood and apple pie of development economics—which makes Mr Rodrik's confession the more striking. The rule of law is held to be not only good in itself, because it embodies and encourages a just society, but also a cause of other good things, notably growth. “No other single political ideal has ever achieved global endorsement,” says Brian Tamanaha, a legal scholar at St John's University, New York.

But as an economic concept the rule of law has had a turbulent history. It emerged almost abruptly during the 1990s from the dual collapses of Asian currencies and former Soviet economies. For a short time, it seemed to provide the answer to problems of development from Azerbaijan to Zimbabwe, until some well-directed criticism dimmed its star. Since then it has re-established itself as a central concept in understanding how countries grow rich—but not as the panacea it once looked like.

Economists became fascinated by the rule of law after the crumbling of the “Washington consensus”. This consensus, which was economic orthodoxy in the 1980s, held that the best way for countries to grow was to “get the policies right”—on, for example, budgets and exchange rates. But the Asian crisis of 1997-98 shook economists' confidence that they knew which policies were, in fact, right. This drove them to re-examine what had gone wrong. The answer, they concluded, was the institutional setting of policymaking, especially the rule of law. If the rules of the game were a mess, they reasoned, no amount of tinkering with macroeconomic policy would produce the desired results.

This conclusion was strengthened by events in the former Soviet empire. Many post-communist countries got their policies roughly right fairly quickly. But it soon became clear this was not enough. “I was a traditional trade and labour economist until 1992,” says Daniel Kaufmann, now head of the World Bank Institute's Global Governance group. “When I went to Ukraine, my outlook changed. Problems with governance and the rule of law were undermining all our efforts.”

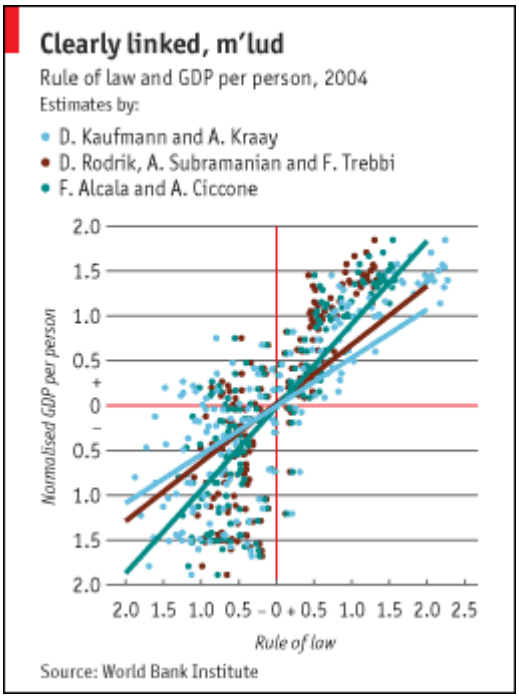
Pretty quickly, “governance”—political accountability and the quality of bureaucracy as well as the rule of law—became all the rage. Economists got busy calculating what it was, how well countries were doing it

and what a difference it made. Mr Kaufmann and his colleague Aart Kraay worked out the “300% dividend”: in the long run, a country's income per head rises by roughly 300% if it improves its governance by one standard deviation. One standard deviation is roughly the gap between India's and Chile's rule-of-law scores, measured by the bank. As it happens, Chile is about 300% richer than India in purchasing-power terms. The same holds for South Africa and Spain, Morocco and Portugal, Botswana and Ireland. Economists have repeatedly found that the better the rule of law, the richer the nation. (The chart below shows the results of three studies, put on a comparable basis by Mr Kaufmann.) Every rich country with the arguable exceptions of Italy and Greece scores well on rule-of-law measures; most poor countries do not.

Mr Rodrik reviewed the contributions to growth of governance (“institutions”, he called it), geography and openness to trade. He concluded, to use the title of an article he published in 2002, that “Institutions Rule”. Writing from the perspective of a political scientist, Francis Fukuyama of Johns Hopkins University concurred: “I believe that the institutionalists have won this argument hands down.”

Partly because of this, and also because the rule of law is desirable for its own sake, governments and aid agencies began splurging money on rule-of-law reforms, such as training judges, reforming prisons and setting up prosecutors' offices. Such reforms had begun in Latin America in the mid-1980s. Now they became universal.

The European Union insists that all its members satisfy standards for the rule of law. It requires applicants to commit themselves to legal reforms to meet those standards and dispatches armies of lawyers to advise them how to bring their legal systems up to scratch. America's Millennium Challenge Corporation, set up in 2004 to improve the effectiveness of American official aid, confines its largesse to countries that have committed themselves to minimum rule-of-law standards (one of three basic requirements). Western donors have poured billions into rule-of-law projects over the past 20 years. The World Bank is now running such projects (narrowly defined) worth almost $450m; on a wider definition, almost half the bank's total lending of $24 billion in 2006 had some rule-of-law component (for example, advice on conflict resolution in village-development projects, or on bankruptcy law in privatisation programmes). In roughly a decade the rule of law has gone from a specialist political and legal topic into a staple of economic thinking and the subject of a vast aid-giving effort.



So it came as an unwelcome surprise when, in 2003, one of the world's acknowledged experts on governance wondered aloud whether the emperor had any clothes. Thomas Carothers of the Carnegie Endowment for International Peace, a think-tank in Washington, DC, wrote a paper politely entitled “Promoting the Rule of Law Abroad: The Problem of Knowledge”. According to Mr Carothers, the problem was, as William Goldman said of Hollywood, that nobody knows anything.

Mr Carothers argued that the intrinsic difficulty of defining the rule of law, combined with the problems of knowing how specific laws work in practice, meant that “the rapidly growing field of rule-of-law assistance is operating from a disturbingly thin base of knowledge at every level.” Many of the difficulties are inherent, he said. But not all: aid organisations always look forward to the next project, rather than back to the lessons of experience; lawyers who carry out the work are not much interested in development; university professors are not gripped by applied policy research. As a result, according to one rule-of-law promoter, “deep down, we don't really know what we are doing.”

The shock of Mr Carothers's argument was salutary. In response, there has been a flurry of rule-of-law studies. A new body of work has appeared, which could be called the economics of the rule of law. It shows the rule of law can indeed be improved. It has made clearer what economists and others mean when they talk about the rule of law. It has laid down some guidelines about reforms, helping show what works when, say, training judges or policemen. What it has not yet shown beyond doubt is that the rule of law is a precondition for economic growth everywhere. In the process, the subject of law as an economic matter has begun to grow up. It has passed from vigorous childhood into more troubled adolescence.

Unruly law

In “The Rule of Law and Development” (to be published next month by Edward Elgar), Michael Trebilcock of the University of Toronto and Ron Daniels of the University of Pennsylvania tackle the question of what economists mean by the rule of law. A report by a new research group, the Hague Institute for the Internationalisation of Law, does the same thing. Both publications argue that people routinely use two quite different definitions, which they call “thick” and “thin”.

Thick definitions treat the rule of law as the core of a just society. In this version, the concept is inextricably linked to liberty and democracy. Its adherents say a country can be spoken of as being ruled by law only if the state's power is constrained and if basic freedoms, such as those of speech and association, are guaranteed. The “declaration of Delhi” drawn up by the International Commission of Jurists in that city in 1959 followed this line in saying that the rule of law “should be employed to safeguard and advance the civil and political rights of the individual” and create “conditions under which his legitimate aspirations and dignity may be realised.” Among other proponents of a thick definition are Friedrich Hayek, an Austrian economist, and Cass Sunstein of the University of Chicago. In their view, the rule of law includes elements of political morality.

Thin definitions are more formal. The important things, on this account, are not democracy and morality but property rights and the efficient administration of justice. Laws must provide stability. They do not necessarily have to be moral or promote human rights. America's southern states in the Jim Crow era were governed by the rule of law on thin definitions, but not on thick.

The existence of competing definitions of something may seem fatally to undermine its usefulness. If you argue that the rule of law is vital to growth, which version do you mean—the one that defends human rights or the one that guarantees property rights? But economists love competition. Their differing definitions of the rule of law reflect competing explanations of what drives economic growth.

One account of growth—associated with Douglass North of Washington University in St Louis, Missouri—is “institutional”. It focuses on the importance of property rights, transaction costs and economic organisation. On this view, stable, predictable laws encourage investment and growth. Thin definitions of the rule of law fit this well. The other—associated with Amartya Sen of Harvard—says that if you expand people's “capabilities” (Mr Sen's term), they will do things that help countries grow rich. Freeing people to take advantage of their capabilities usually means lifting the oppressive burden of the state and guaranteeing certain basic rights—a much thicker concept.

The distinction between thick and thin versions of the rule of law overlaps another distinction between legal traditions. Starting in 1997, a group of economists led by Andrei Shleifer of Harvard and Robert Vishny of Chicago started to compare the economic performance of common-law countries (such as America and Britain) with that of civil-law ones (France, Germany and Scandinavia). They argued that common-law countries have more secure property rights, better protection of shareholders and creditors, more diversified share ownership, and tougher disclosure and liability laws—to the benefit, they claimed, of stockmarket performance.

Like the initial claims for the rule of law, those on behalf of the common law were subject to harsh criticism at about the same time, mostly from continental economists. Some claimed the differences between common and civil law were not as sharp as they seemed, and were proxies for differences of politics, history and culture. Others pointed out that a country's legal origins do not seem to explain much about how it is faring economically or in terms of the rule of law. North and South Korea have the same legal origins.

But just as rule-of-law scholars have responded to criticism with more research, so have the legal-origins crowd. In a stream of papers they have found strong evidence that civil-law countries encourage government ownership of the media and banks, a higher burden of entry into business, more labour-market regulation and greater formalism of court procedures—to their detriment, they claim.

Perhaps such arguments can never be resolved. As Rainer Grote of the Max Planck Institute for Comparative Public Law and International Law in Heidelberg says, the rule of law “belongs to the category of open-ended concepts which are subject to permanent debate.” This part of the new economics of the rule of law clarifies its role, but no more. Other findings, though, are more constructive.

Scales of justice

There have been huge improvements in monitoring and measuring the rule of law, even though people cannot agree exactly what it is. “Fifteen years ago, we didn't talk about this stuff,” says Steve Radelet of the Centre for Global Development, a Washington think-tank. “Ten years ago, there was no data.” Now, the Worldwide Governance Indicators project—“one of the best kept secrets at the World Bank”, believes Gordon Johnson, a grand old man of aid-giving—is the state of the art. It gathers data on more than 60 indicators (the extent of crime, the quality of police, judicial independence and so on) to create rule-of-law and governance measures for virtually every country in the world. Aggregating like this (and being honest about the margin of error), says Mr Kaufmann, is far from perfect, but is a decent approximation.

These measures confirm what is clear anyway: some countries have been able to improve their legal framework even in a short time. In 2000 Mikhail Saakashvili, then Georgia's minister of justice, sacked two-thirds of his country's judges for failing to pass an exam. Four years later as president, he fired all the country's traffic police. Georgia's World Bank rule-of-law score rose from nine out of 100 in 2002 (in the bottom 10%) to 33 at the end of 2006—low, but better. Central European and Baltic countries are doing better still: the radical legal changes required by membership of the EU improved their economies as well as their judicial systems.

In general, the measures suggest, bold reforms work better than gradual ones. Latin America modernised its penal codes and made trials more transparent. Chile, for instance, established a new public-prosecution system beginning in 2003. But many of its officials lack experience and have met resistance from the police. Russia implemented some judicial reforms in the 1990s and raised spending on the courts in 2000—to no avail: its rule-of-law scores have fallen in five of the past seven years.

The difference between central Europe and Latin America may be one of political backing. Messrs Trebilcock and Daniels divide countries into three: those where politicians, legal professionals and the public all support reform (central Europe after the fall of communism, South Africa after apartheid); those where politicians support reform, but lawyers and police do not (Chile and Guatemala); and those where lawyers want change, but not politicians (Pakistan). Only in the first group, the professors say, does rule-of-law reform get far.

Consistent with that rather gloomy finding, some new research finds only a weak link between the rule of law and economic growth. The connection with wealth is well established (see chart again) but that is different: it has been forged over decades, even centuries. The link with shorter-term growth is harder to see. China appears to be a standing contradiction to the argument that the rule of law is needed for growth. It is growing fast and is the world's largest recipient of foreign investment, yet has lots of corruption and nothing that most Westerners would recognise as a rule-of-law tradition. (It does, though, guarantee some property rights and its government is good at formulating and implementing policies.)

On the other hand, there is surely a connection between the legal reforms carried out in central Europe and the Baltics and their fast growth rates, or between Spain's post-Franco legal opening and its long boom. And there are proxy indicators connecting legal reform with growth in other areas. The value of rural land in Brazil, Indonesia, the Philippines and Thailand increased sharply when people were given title deeds, because owners were more willing to invest. One independent study for the World Bank a decade ago found a surprising link between projects the bank financed and civil liberties: projects in countries with strong civil liberties had far higher rates of return than those in countries with weak traditions of liberty.

But such links do not tell you anything about causation. Perhaps growth helps the rule of law, not vice versa. Perhaps countries can afford the luxury of the rule of law only after they have grown rich. The persistence of “frontier justice” into the 1930s in America gives a colour of plausibility to that idea.

Yet it is not Mr Kaufmann's view. He argues that rule-of-law improvements tend to help growth; that few countries have sustained gains in growth without improving their rule of law; and that places that have grown without such improvement have subsequently lurched backwards (Argentina used to be one of the ten richest countries in the world). The real puzzle is to explain the exceptions: why crony capitalism has flourished in parts of fast-growing Asia or Kremlin banditry in Russia. The answer, he says, is that, without a rule of law, well-connected crooks can grab an unfair share of the spoils of growth, especially if these include windfall gains from oil and raw materials.

The existence of crony capitalism and “state capture” by robber barons is, of course, an argument for trying to strengthen the rule of law where you can, since it suggests growth will not necessarily create

law automatically. There are other arguments, too: the rule of law is desirable for its own sake—to improve human rights or to increase citizens' chances of justice against predatory governments. As John Locke wrote in 1690, “wherever law ends, tyranny begins.” Plainly, in some countries, such as Myanmar and Zimbabwe, legal abuses and over-mighty regimes are direct obstacles to growth. Reforms would help—if they could be implemented.

But as a generalisation, the efforts of the past few years have thrown up mixed messages. They suggest the rule of law can be improved sharply; that rule-of-law reform is at root a political not a technical undertaking; and that it is linked to growth, if weakly in the short term. But they do not really bear out the assertion that the rule of law is an underlying prerequisite for growth. Rather, the more economists find out about the rule of law, the more desirable it seems—and the more problematic as a universal economic guide.

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Credit markets

If at first you don't succeed

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From The Economist print edition

Illustration by Satoshi Kambayashi

The Fed tries to flush out the credit markets once again—but the stink lingers

THIRD time lucky? The credit markets almost seized up in August, December and again this month and on each occasion the Federal Reserve has led a rescue attempt (see article). Its latest effort led to a bout of euphoria on Wall Street, with the S&P 500 index managing its biggest one-day increase in over five years on March 11th. But every time the Fed has unblocked the drains somewhere in the credit markets, they have bunged up elsewhere. Sure enough, on March 13th panicky investors sent the dollar tumbling below ¥100 and pushed gold above $1,000 an ounce.

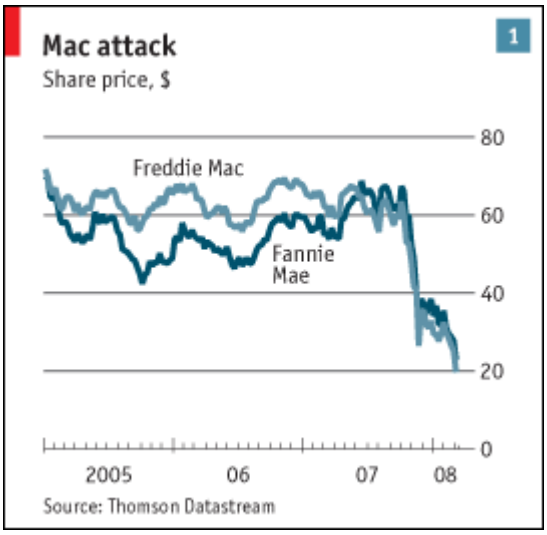
The fear is that the financial markets have entered a negative spiral, the obverse of the kind of euphoria that drove dotcom stocks to absurd valuations in 1999 and early 2000. Back then, investors scrambled to buy shares regardless of their price. This time round, they are being forced to sell bonds and loans, whether or not they believe the borrowers will eventually repay. The problems are exacerbated by the demise of the securitisation market, and fears about counterparty risk. Both those factors are making banks less willing to lend—even to worthy borrowers. They will become ever more cautious the deeper America's economy tips into recession.

Debt, such an exalted financing tool a little more than a year ago, is now a four-letter word. In the boom, banks were able to lend money via bonds and loans and then unload the debts in the form of structured products. Even when yield spreads narrowed, investors simply spiced up their portfolios with more debt to produce higher returns. But once the problems in the subprime market became clear, the appetite for structured products collapsed, and the process went into reverse.

Oddly enough, the problem is particularly intense in an area of the market that, in theory, should have been the safest; paper given AAA-like ratings by the agencies. There are no longer end buyers for this paper. The yields on such assets are too low to make them of interest except to geared investors. And there is scant lending available, even if investors wanted to gear up their portfolios in these volatile times.

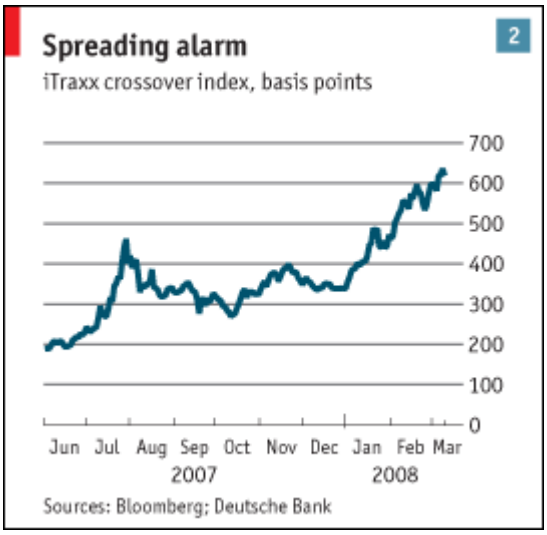
Also, the investment banks that deal with hedge funds are tightening lending standards. This may involve higher margin payments or a bigger “haircut” shaved off the value of assets pledged as collateral. According to one banker, even government bonds pledged as collateral are facing haircuts for the first time in 15 years.

That may make sense for each individual bank, but at the systemic level it makes matters worse for everyone. Hedge funds are being forced to sell their best assets to meet their debts, adding to the air of crisis. A dramatic case is Carlyle Capital, a bond fund run by the Carlyle Group, a private-equity firm (see article). On March 12th it said it had defaulted on $16.6 billion of debt and expected to default on the rest, after failing to reach an agreement with its creditors. The fund used gearing of 32 times to buy AAA-rated paper and has had to sell assets to meet margin calls. Some of that debt was issued by Fannie Mae and Freddie Mac, the two quasi-governmental agencies that guarantee mortgage debt. As Carlyle sold, the prices of their debt fell, increasing concern about their finances (see chart 1). In early March the spread between yields on Fannie Mae debt and Treasury bonds was higher than at any time since 1986.



This helps explain why the new Fed facility allows primary dealers to pledge AAA-rated mortgage securities as collateral for borrowings. If confidence can be restored in that part of the market, perhaps the negative spiral can be broken.

Analysts were by no means convinced, however. Rob Carnell of ING described the measures as a “palliative to market fragility, rather than a cure.” Nor was the initial reaction in parts of the credit markets particularly encouraging. The cost of insuring against corporate-bond defaults did not fall sharply (see chart 2). Meanwhile, the interbank rate needed to borrow euros for three months hit 4.6%, the highest level since January and more than half a percentage point above official euro-zone rates. That indicated banks still preferred to hold cash rather than lend it.



The hoarding is a natural consequence of the breakdown of the securitisation market. Banks know that it will be more difficult to offload any new loans. They are also saddled with old loans, either because they have been unable to sell them, or because they have taken structured investment vehicles onto their balance sheets to protect their reputations.

When banks get more nervous about lending, that tends to have wider consequences. Companies will find it more difficult to borrow; weaker ones will accordingly get into trouble. According to Matt King, a credit strategist at Citigroup, the single biggest factor influencing corporate default rates is banks' willingness to extend credit—as measured by the lending surveys of the Fed and the European Central Bank. Nor is it likely that the full impact of tighter lending standards on consumer demand has been felt.

David Bowers of Absolute Strategy Research, a consultancy, reckons that the credit crisis has also undermined the willingness of foreigners to finance America's current-account deficit. Data show that overseas investors own some $1.5 trillion of asset-backed debt, investments that have gone badly wrong. They will not be willing to lend in the same way again.

And the effects of the crisis are showing up in some unexpected places. One of the latest casualties is the sewer system of Jefferson county, Alabama. The county, which includes the city of Birmingham, had agreed to interest-rate swaps worth a remarkable $5.4 billion in an attempt to limit its financing costs. But the rationale for the deal was undermined by the credit problems of the “monolines”, which insured the sewer system's bonds. The result was a sharp rise in financing costs. A group of banks led by JPMorgan Chase is asking it to put up a further $184m in collateral; the county is refusing.

As the dispute rumbles on, the sewer system's debt has been downgraded all the way to CCC by Standard & Poor's, a rating agency. One thing is certain. If the credit crunch continues, the residents of Jefferson County won't be the only ones holding their noses at the stink.

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Buttonwood

Privates on parade

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Public markets and private equity have not mixed

HAVING a reputation for being shrewd can, paradoxically, be a problem. When Blackstone, the group best known for its private-equity operations, floated on the American stockmarket last year, many people saw it as a top-of-the-market signal. After all, if the smart money was selling, who would be a buyer?

Events have made the Blackstone founders look shrewder than ever. The shares have fallen by around half since the firm's flotation and fourth-quarter profits, announced on March 10th, were down by 89%. Whether this performance has enhanced the long-term appeal of the Blackstone brand is another matter. Will there be a queue of buyers when Blackstone next has something to sell?

Similar problems have beset other private-equity firms that have gone public. Last year's flotation of Fortress Group also proved a disappointment. And two of the credit funds that have recently got into trouble were run by Kohlberg Kravis Roberts and the Carlyle Group, both part of the private-equity aristocracy. Carlyle launched a highly geared fund to invest in mortgage-backed securities last July, just as the credit crunch was setting in. It succeeded in raising $300m, but that was a Pyrrhic victory, given how much its implosion has damaged the parent company's reputation.

Flotations also cut against the rationale of the industry—that companies can be run better in private hands than public ones. The interests of managers and investors can be more closely aligned, both by restricting the number of shareholders and by giving managers incentives to perform well. Managers can make decisions without worrying about the need to meet the next quarterly-earnings target. However, ideology is one thing, expediency is another. An initial public offering is the only way for a private-equity group to realise the value of its goodwill (and to put its owners at the top of the rich lists).

Cynics would suggest the business has less to do with management skills and more to do with financing, anyway. Private-equity firms use tax-deductible debt to buy public companies. When interest rates were low or falling, credit was plentiful, and recessions were both rare and mild, that made sense. But it may not do so when credit is restricted, interest rates are volatile and the economy is in trouble. In other words, in conditions like today's.

The obvious parallel is with the industrial conglomerates of the 1970s and 1980s. They were initially widely praised for their superior management skills in bringing “synergies” to their diversified businesses. Eventually investors decided that these skills were largely an illusion. Instead, running a conglomerate was all about a financing trick; using highly rated shares to buy companies on lower valuation multiples.

These days, the private-equity groups are turning themselves into financial, rather than industrial, conglomerates—the next generation of Morgan Stanleys. Blackstone runs funds of hedge funds and doles out investment-banking advice, for example. It can even act as a minority investor in other people's deals—buying the bonds of good companies that are trading at distressed prices.

But these activities also dilute the purity of the private-equity concept. Minority stakes do not bring the governance improvements that private equity boasts of. And if investors want to give money to a bond manager, why not to the likes of Pimco, which would charge a lot less for the privilege?

All this is happening at a time when there is still debate on the economic benefits of the industry. A study by Josh Lerner of the Harvard Business School and Anuradha Gurung of the World Economic Forum analysed the record of more than 21,000 private-equity transactions between 1970 and 2007. On the positive side, it found that the firms acquired by private-equity groups had a pretty good record in terms of innovation, as measured by patent applications.

But, unlike other studies, on the more politically sensitive issue of employment it found that acquired

companies lost around 7% more jobs, relative to a control group, in the two years after a buy-out. This was partly offset by the creation of jobs in wholly new areas in later years.

Any conclusions, however, can only be tentative. Of the $3.6 trillion of transactions in the study period, three-quarters have taken place since 2001. We do not yet know what the economic impact of those deals will be or whether investor returns can be as high as they were in the much less crowded markets of the 1980s and 1990s. The grand claims of the private-equity business are facing their most severe test to date.

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Welfare economics

When bribery pays

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Paying parents to do what is right for their children is all the rage

IT IS not every day that an American city takes lessons in bribery from Latin America. But New York City's Opportunity NYC programme, a privately funded scheme that rewards parents and children with cash for doing such things as getting proper health check ups and passing school exams, owes a debt of gratitude south of the border. Britain and other European countries are looking into similar reforms. In doing so, they raise a big question: should people be paid for doing what it is already in their interest?

The popularity of these initiatives dates back over a decade to Mexico, which replaced unconditional cash handouts to the poor with conditional cash transfers (CCTs). That meant the money had strings attached: it came, for example, as long as children stayed in school, had regular medical check-ups, and infants and pregnant mothers took nutritional supplements. Maureen Lewis of the World Bank argues that CCTs have "caught fire now" because they have worked in a wide range of circumstances, from Brazilian slums to villages in Nicaragua and Mexico.

Mexico's *Oportunidades* scheme (hence the name in New York) is discussed in the *Lancet*, a British medical journal, by academics at the University of California, Berkeley. It finds that the conditional money improved children's height, reduced their obesity, and improved their motor and cognitive development as well as their language skills.

One reason for the success is that the extra cash helps break down barriers. Very poor parents lack both the free time and the money to take children to the doctor, for example, so a small sum that helps cover the cost of transportation or lost wages is often enough to motivate them. It may not work in all countries, however: offering cash for check-ups to poor rural Africans will not accomplish much if there is no doctor or clinic nearby.

Another reason CCTs work is that they encourage the poor to redefine their self-interest. Many parents on the breadline keep children out of school so that they can earn much-needed income. Injecting cash can free parents to send their children to school. Also, because the very poor often have to struggle so hard that survival itself is often in doubt, their calculation of self-interest often heavily discounts future welfare. Conditional cash seems a good way to spur longer-term thinking that benefits both the individual and society.

Fine, say sceptics, CCTs may work in poor countries but surely they are not relevant in beacons of prosperity like New York City. After all, such places have social safety nets and laws against child labour, so the poor are less likely to be so desperate that cash payments influence their behaviour. Linda Gibbs, New York's deputy mayor, strongly disagrees. She insists that welfare mothers in her city face the same sorts of crushing shortages of time and money that Latin America's poor face: "Does that mother take her child to the doctor or go to work?" A big enough cash incentive, she argues, can persuade that mother to take time off work to get her child's health check-up.

To test that theory, the city is encouraging several pilot programmes partly funded by a charity run by Michael Bloomberg, the mayor, that offer cash to families and teachers for improving performance in health and education. REACH, another private philanthropy outfit in the city, is offering cash directly to students in poor neighbourhoods who excel at advanced-placement exams designed for college-bound students. Blacks, who make up nearly 15% of the city's student body, earn fewer than 4% of the top marks in such exams today. But a similar scheme in Dallas has managed to increase the number getting top scores by 30%.

Is this just another stride in the forward march of the nanny state? Anything but the narrowest schemes could be fiendishly complex to manage, hard on the public purse, and additionally demotivating for those who are left behind. Offering cash to change long-term bad habits, such as smoking or over-eating, has

not worked. But disbursements tied to short-term transactions, such as getting drug addicts to take treatments for tuberculosis or depressed patients to see their psychiatrists, have already shown promise. As one New York official indelicately puts it: “Cash talks and bullshit walks in this city.”

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Central bank interventions

Bonding session

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With banks and hedge funds scrambling for liquidity, the Fed gets more daring

GONE are the genteel days when a central bank's role in oiling financial markets was limited to providing short-term cash loans in exchange for slightly less liquid collateral. The co-ordinated action announced by five big central banks on March 11th was proof of that.

At its centre was the Federal Reserve, which unveiled a new arrangement, the Term Securities Lending Facility (TSLF). This will enable primary dealers to borrow up to $200 billion of Treasury securities for 28 days and to proffer less creditworthy bonds as collateral.

Earlier, the Fed had announced it was increasing the size of its Term Auction Facility (TAF), set up last December to supply one-month loans to deposit-taking banks. The bank also offered $100 billion of four-week loans against standard collateral to primary dealers.

These TAF deals, cash loans backed up by bond collateral, are conventional even if the loans are for longer and the eligible security more liberal than in normal times. The TSLF is different: it is a bond-for-bond arrangement aimed explicitly at providing liquidity to markets beyond those where cash is traded. The facility should deepen the pool of Treasuries, which are in strong demand during liquidity crises. At the same time, by providing a temporary home for illiquid bonds, albeit top-rated ones, it should ease markets that presently have few buyers.

The scale of the TSLF raises concerns that the Fed, in its attempt to reduce liquidity risk, is taking on too much credit risk. After all, swapping pristine government bonds for dodgier assets lowers the quality of the Fed's balance sheet and $200 billion represents around a quarter of the Fed's asset base. This risk is real but easily overstated. The lowest collateral the Fed will accept is AAA-rated private mortgage-backed bonds that are not on review for downgrade. A “haircut” will be applied to protect the Fed against a fall in the value of the collateral. And the Fed reserves the right to demand other assets if pledged collateral turns bad. Hence the risk of falling asset values stays with the borrower. The Fed only runs a risk of being left holding ropy assets if one of its counterparties goes bust.

If the Fed went further and started to buy illiquid assets outright, as some are advocating, that would be different. It would involve the central bank in setting prices and would expose it to all the future risk of asset-price falls. There is a world of difference between this kind of intervention—which takes the burden of price discovery and the risk of future declines in asset prices from private investors—and bolstering liquidity by accepting riskier assets as collateral. The ECB, with its more liberal collateral regime, runs the second, milder sort of credit risk all the time—and it offers term lending for up to three months. The Fed says it was unwilling to go that far, because funding for longer than 28 days may displace private markets. Even so, it has gone much further than many thought likely.

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Commodities

Shooting up

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Corn prices hit with both barrels

BRITAIN'S pheasants are enjoying a peaceful few months after the end of the shooting season on February 1st. Not so the country squires who pay to have them lovingly nurtured ahead of the avian equivalent of the Somme next autumn. If their hobby was already an expensive one, it has become even more so with corn prices rising as fast as a bird out of the cover.

The problem is that pheasants, like all other creatures, have to eat. “The shoot finances were hammered last season by the large increase in the price of corn from which all shoots have obviously suffered,” writes one manager, informing clients of an increase in the daily cost, per gun, from £795 ($1,610) to £845.

Only around 40% of the pheasants end up being shot; the rest wander off or get eaten by foxes. But the shoot managers, who buy the birds at around eight weeks old, have to feed the lot. And Charles Nodder, a consultant to the Game Farmers' Association, says the industry has also been hit by the higher cost of fuel to keep the chicks warm.

If the shooting lobby is to be believed, their sport is a surprisingly big business, contributing £1.6 billion to British GDP and creating 70,000 jobs. Members of shooting parties pay around £30-35 a bird to test their aim (though, once killed, the wholesale meat value is well under £1). Luckily for the shooting syndicates, a price rise of 5-6% is not likely to put off the bond traders and hedge-fund managers who have become devotees of the sport. Like the pheasants, they are ripe for a plucking.

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Chinese inflation

Sweet and sour pork

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Are rising prices in China driven by the supply of meat or money?

IN A country where bouts of inflation have triggered social unrest, the jump in China's inflation rate to a 12-year high of 8.7% in February is cause for concern. But economists are sharply divided on the cause of this inflation and the degree to which policy needs to be tightened.

The People's Bank of China (PBOC) is expected soon to lift interest rates and banks' reserve requirements once again. Some people fear a repeat of 1987-88 or 1993-94 when high inflation forced the government to tighten monetary policy sharply, causing a hard economic landing.

One difference between today and previous surges in inflation is that the increase over the past year has been caused mainly by food prices, which jumped by 23%. Vegetable prices are 46% higher than a year ago, pork is 63% dearer. The impact of various supply shocks, notably blue-ear disease which killed thousands of pigs, were aggravated last month by the worst snowstorms for 50 years, damaging crops and disrupting transport. Non-food prices rose by only 1.6% over the past year. In 1994, by contrast, non-food inflation hit 20%.

To the extent that food prices have been pushed up by one-off supply factors, they should flatten later this year, causing inflation to fall. If so, it is argued, there is no need to slam on the brakes. Moreover, higher interest rates would do little to curb food prices. Some policy makers also worry that if China raised interest rates sharply at the same time as America is cutting them, this would attract bigger capital inflows and the extra liquidity could actually worsen inflationary pressures.

Indeed, some economists believe that excess money is already partly to blame for rising inflation. In the past there has been a tight correlation between China's inflation and money-supply growth. Monetary growth surged before both bouts of inflation in 1987-88 and 1993-94. In 1993 the annual rate of growth of the M2 measure of money hit 40%.

Today it is less clear that the money supply is out of control. Over the past year M2 rose by 17.5%, not much faster than the average during 1998-2003 when prices were flat or falling. But Hong Liang, an economist at Goldman Sachs, reckons that the M2 measure of money understates the amount of liquidity sloshing around in China. She prefers M3, a broader measure, which includes deposits in non-bank financial institutions and securities issued by financial institutions. According to her calculations, M3 growth has risen sharply since 2005, from around 15% to 23%. This suggests that higher inflation could prove to be more persistent and spread from food to other goods and services, requiring the PBOC to tighten by much more.

But another difference between today and previous bouts of inflation is that in the past rising inflation went hand-in-hand with a widening current-account deficit—a classic symptom of overheating. Today China has a huge surplus. This offers another tool to fight inflation: a more rapid appreciation in the yuan alongside a modest interest-rate rise could curb imported inflation and cause less harm to domestic demand. Indeed, this is something that most economists can agree on: regardless of what is driving inflation up, a stronger yuan would help to pull it down.

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Banks and climate change

The greening of Wall Street

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From The Economist print edition

Tackling the carbon crisis amid the credit crisis

Eyevine

At the end of Kyoto's rainbow

WHEN better to further the cause of financial greenery than St Patrick's Day? On March 17th the first carbon-linked derivatives contracts will begin trading on the Green Exchange, a joint venture between the New York Mercantile Exchange, Evolution Markets, a broker, Morgan Stanley, Merrill Lynch and others. America already has a small emissions-trading market in the Chicago Climate Exchange, run by one of the founding fathers of financial derivatives, Richard Sandor. Nevertheless, the NYMEX venture is seen as America's boldest step yet towards the carbon-trading big league.

Thanks to its participation in the Kyoto protocol on climate change, Europe dwarfs America in carbon trading. The bulk of the €40 billion ($62 billion) of credits traded last year—up 80% on 2006—changed hands on European markets. But with the science of climate change no longer widely disputed and all three remaining presidential candidates in favour of bringing a similar cap-and-trade system to America, Wall Street is taking the environment a lot more seriously. The potential rewards are huge. New Energy Finance, a research firm, thinks the American market for carbon emissions could reach $1 trillion by 2020 if the front-runner among the several climate-change bills wins approval in Congress. Add in derivatives and it could be many times bigger, points out Blythe Masters of JPMorgan Chase.

Though America pioneered a cap-and-trade system in two acid-rain gasses in the 1990s, European financial institutions are still some way ahead on greenery. A recent report from Ceres, a coalition of investors and environmental groups, put HSBC and ABN AMRO at the top of the pile. But the Americans are catching up. Citigroup has pledged $50 billion to green initiatives over ten years, including $31 billion for clean technologies. Bank of America (BofA) has made a $20 billion commitment. Alone among big banks, it has also said it will put a price on carbon dioxide (of between $20 and $40 per ton) when scrutinising loan requests from industry. Citi, JPMorgan Chase and Morgan Stanley recently unveiled a set of “carbon principles” that will tighten financing terms for smoke-belching power plants.

A number of Wall Street banks are also offering green-tinged merger advice. Goldman points to its role in last year's takeover of TXU by a private-equity consortium. The buyers won plaudits for crafting a deal that allowed the utility to scale back its building programme for coal plants. Mark Tercek, Goldman's green guru, argues that the key for advisers faced with heavy polluters is “not to disengage, but to make bad situations better.”

Banks also see plenty of consumer opportunities in global warming. BofA, for instance, offers green credit cards (where purchases earn carbon offsets) and mortgages ($1,000 cashback for energy-efficient homes). It even offers $3,000 to employees who buy a hybrid car. It sees great potential in solar-panel leasing. Green mutual and exchange-traded funds are booming, says Deutsche Bank's Mark Fulton. He has counted some 250.

Wealthy investors are piling in too. One bank says it has fielded a dozen enquiries recently from individuals each looking to invest between $50m and $100m. One attraction is that carbon is uncorrelated with other markets—though poor regulation can knock prices for six, as it did in Europe in 2006. Hedge funds like it because it is an immature market, and thus offers arbitrage opportunities. Peter Fusaro of Global Change Associates, a consultancy, knows of 75 environmental hedge funds, up from a couple three years ago.

Not everyone is convinced. Steve Milloy of the Free Enterprise Action Fund, a mutual fund run by climate-change sceptics, claims the banks' environmental initiatives are “at best greenwashing, and at worst value-destroying”. Its shareholder-resolution targets include Citi and Lehman Brothers (whose green initiatives are run by Theodore Roosevelt's great-grandson). Jim Rogers, the boss of Duke Energy, a big power company, says the banks are being disingenuous: they may cut funding for a power-plant project, but they will not tighten loan terms for its parents.

The question now is whether the management distractions and financial demands of the credit crunch dull Wall Street's enthusiasm for greenery. After all, something similar happened in the 1990-91 crash, after years of pre-Kyoto excitement. Michael Klein, co-head of Citi's markets and banking group, insists not: Citi continues to beef up in the area, despite its own troubles. Others also seem determined. Giddy oil prices, meanwhile, will only increase interest in alternative energy. There is strong social pressure not to sink back into old habits. This time the revolution looks to be for real.

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Economics focus

Grossly distorted picture

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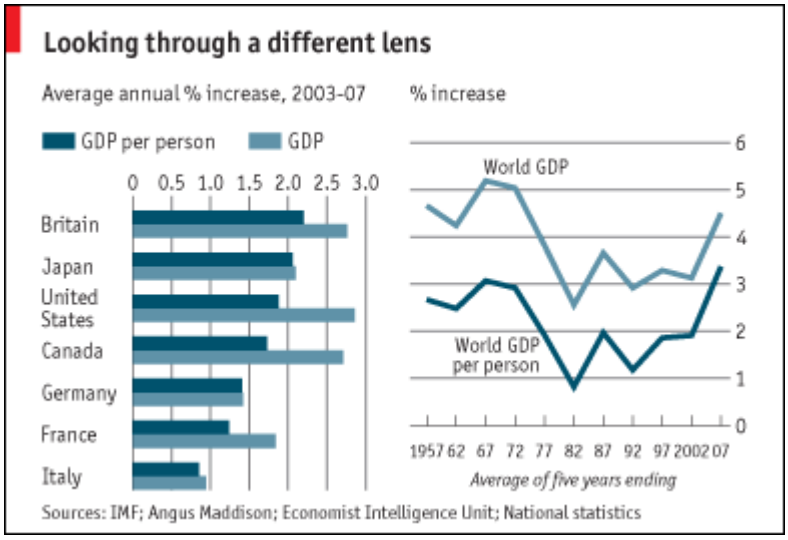
If you look at GDP per head, the world is a different—and, by and large, a better—place

WHICH economy has enjoyed the best economic performance over the past five years: America's or Japan's? Most people will pick America. The popular perception is that America's vibrant economy was sprinting ahead (albeit fuelled by credit and housing bubbles that have now painfully burst), whereas Japan crawled along at a snail's pace. And it is true that America's average annual real GDP growth of 2.9% was much faster than Japan's 2.1%. However, the single best gauge of economic performance is not growth in GDP, but GDP per person, which is a rough guide to average living standards. It tells a completely different story.

GDP growth figures flatter America's relative performance, because its population is rising much faster, by 1% a year, thanks to immigration and a higher birth rate. In contrast, the number of Japanese citizens has been shrinking since 2005. Once you take account of this, Japan's GDP per head increased at an annual rate of 2.1% in the five years to 2007, slightly faster than America's 1.9% and much better than Germany's 1.4%. In other words, contrary to the popular pessimism about Japan's economy, it has actually enjoyed the biggest gain in average income among the big three rich economies. Among all the G7 economies it ranks second only to Britain (see left-hand chart).



Using growth in GDP per head rather than crude GDP growth reveals a strikingly different picture of other countries' economic health. For example, Australian politicians often boast that their economy has had one of the fastest growth rates among the major developed nations—an average of 3.3% over the past five years. But Australia has also had one of the biggest increases in population; its GDP per head has grown no faster than Japan's over this period. Likewise, Spain has been one of the euro area's star performers in terms of GDP growth, but over the past three years output per person has grown more slowly than in Germany, which like Japan, has a shrinking population.

Some emerging economies also look less impressive when growth is compared on a per-person basis. One of the supposedly booming BRIC countries, Brazil, has seen its GDP per head increase by only 2.3% per year since 2003, barely any faster than Japan's. Russia, by contrast, enjoyed annual average growth in GDP per head of 7.4% because the population is falling faster than in any other large country (by 0.5% a year). Indians love to boast that their economy's growth rate has almost caught up with China's, but its population is also expanding much faster. Over the past five years, the 10.2% average increase in China's income per head dwarfed India's 6.8% gain.

Focusing on GDP per person also affects comparisons of economic health over time. During the past five years, world GDP has grown by an average of 4.5% a year, its fastest for more than three decades, though not as fast as during the golden age of the 1960s when annual growth exceeded 5%. But the world's population is now growing at half of its pace in the 1960s, and so world income per head has increased by more over the past five years than during any other period on record (see right-hand chart above). Mankind has never had it so good.

Redefining recession

Once you accept that growth in GDP per head is the best way to measure economic performance, the standard definition of a recession—a decline in real GDP over some period (eg, two consecutive quarters or year on year)—also seems flawed. For example, zero GDP growth in Japan, where the population is declining, would still leave the average citizen better off. But in America, the average person would be worse off. A better definition of recession, surely, is a fall in average income per person. On this basis, America has been in recession since the fourth quarter of last year when its GDP rose by an annualised 0.6%, implying that real income per head fell by 0.4%.

Many Americans will shrug this off, especially those politicians who believe that the prime goal of policy is to retain their economic and military dominance over the world. They see the size of a country's GDP as the best measure of its economic clout, in which case the absolute rate of GDP growth matters more than growth in income per head. Europeans seem less bothered about global dominance—although they are sure to gloat about the fact that the weakening dollar means that the euro area could overtake America as the world's biggest economy this year.

There are several other reasons Americans can quibble over the use of GDP per head, especially with reference to Japan. Firstly, its shrinking population is also an ageing one in which the labour force will decline as a share of the population. Unless this is offset by more rapid productivity growth, this could make it harder to maintain the same growth in output per person in future and so harder to pay pension bills. Secondly, slower GDP growth makes it more difficult to reduce the ratio of existing public-sector debt to GDP, which stands at a hefty 180% in Japan. Last, but not least, investors care about GDP growth. Corporate profits depend upon the absolute rate of growth of an economy. And companies wanting to invest abroad will favour markets that are expanding more rapidly.

If GDP per head is nevertheless a superior measure of people's prosperity, why do governments not publish such figures each quarter along with their standard GDP figures? Population statistics tend to be less up-to-date than GDP figures and are generally not available on a quarterly basis. But that is a lame excuse: it should be much easier to count bodies than to put a value on diverse sorts of economic output. Not only do people have a right to know whether average living standards are rising or falling, but publishing such numbers could also benefit some countries. If Japan's government had drawn attention to the sprightlier growth in income per head in recent years, in contrast to endless reports about its “underperforming” economy, consumers may have felt cheerier and spent more—in other words, its GDP growth would have been stronger.

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Internship

Mar 13th 2008
From The Economist print edition

Applications are invited for the 2008 Marjorie Deane internship. This award, financed by the Marjorie Deane Foundation, is designed to provide work experience for a promising journalist or would-be journalist, who will spend three months of the summer at *The Economist*, writing about economics and finance. Applicants may also be considered, if they wish, for an internship of similar duration at *CFO Europe*, a sister publication of *The Economist*. Applicants should send a letter introducing themselves, with an original article of no more than 650 words that they think would be suitable for publication in this section of *The Economist*. Applications should be sent by e-mail to deaneintern@economist.com or posted to the Business Affairs Editor (Deane internship), The Economist, 25 St James's Street, London, SW1A 1HG. They must reach us by April 11th.

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Traffic jams

Turn left. No right. I mean left

Mar 13th 2008
From The Economist print edition

Illustration by David Simonds

Getting from A to B on time is about to become as easy as ABC

THERE is nothing more frustrating than turning on to a motorway and getting stuck in a traffic jam that stretches into the distance. Why did the radio and the motorway-entry sign offer no warning? The satellite-navigation system shows a different route—once you get to the next exit. But it leads through the middle of a town and could be heavily congested, if only because other drivers are taking the same detour. Perhaps it is wiser to stay on the motorway and hope for the best?

Traffic jams cost billions in lost productivity and wasted fuel. Cameras and road sensors aim to give drivers advance warning of problems, but many roads are not covered and the information can be unreliable. Many digital maps use only signposted speeds to calculate journey times and take little account of the way traffic flows change during the week and at different times of the day.

Now help is at hand. As satellite-navigation devices become more widely used, networking effects are making them more powerful. This is because vehicles themselves are starting to relay real-time traffic data—and the more that do so, the more accurate traffic information will become.

The biggest deployment of such a system will take place this summer between New Jersey and North Carolina on 4,000km (2,500 miles) of the congested Interstate Highway 95 and its adjacent roads. The project will collect information on the flow of vehicles using installed road sensors, cameras and first-hand reports, like those from police patrols. To this will be added real-time data relayed from the satellite-navigation systems in thousands of vehicles—mostly lorries, taxis and delivery trucks—that pound along these roads day in, day out. Because their positions will be updated every few minutes, any hold-ups will quickly become apparent.

Clear run

The information will be compiled and processed by INRIX, a company based in Washington state that was spun out of Microsoft in 2004. The data will be used by the highway authorities, emergency services, travel-information providers and the suppliers of navigation devices and services, like TomTom, Garmin and Clear Channel. As many commercial fleets already have the equipment they need to take part (it

locates their vehicles and helps to plan pick-ups and deliveries), INRIX reckons the service could easily spread across much of America's east coast.

Mobile phones in vehicles can also provide real-time traffic data. The idea is to look anonymously at how connections pass from one mobile-phone mast to the next as vehicles travel along a road. TomTom has teamed up with Vodafone to use its mobile network to offer a new premium traffic-information service this year in Britain, Germany and the Netherlands. The system relies on putting a mobile-phone type connection into satellite-navigation devices to receive more extensive traffic updates, so each extra unit that is installed will add to the volume of data. Some users also upload profiles of their journeys. Half-a-billion different speed measurements are now received by TomTom every day to help build its database.

Roads themselves change faster than mapmakers can change maps. Again, networking is helping. TomTom lets users who update the maps on their devices share that information with others (once it has been checked). In the nine months that the service has been running, the maps of 30 countries have received more than 1m updates. As satellite-navigation systems evolve from being devices that just pointed drivers in the right direction, they will find a much greater use as driver-information systems, reckons Mark Gretton, TomTom's director of development.

New services using powerful databases will help that come about. Journey Dynamics, a British company, operates a sophisticated computer-modelling system with historic and live traffic data. It also accounts for things such as the weather, roadworks and the different vehicles using the information: a Porsche can go up hills a lot faster than a heavy lorry can. The idea is to weigh up the likely delays on different routes so that a driver will be able to state with a high degree of confidence the probability of arriving on time, says John Holland, boss of Journey Dynamics. As many drivers already know to their cost, the shortest way is not always the quickest.

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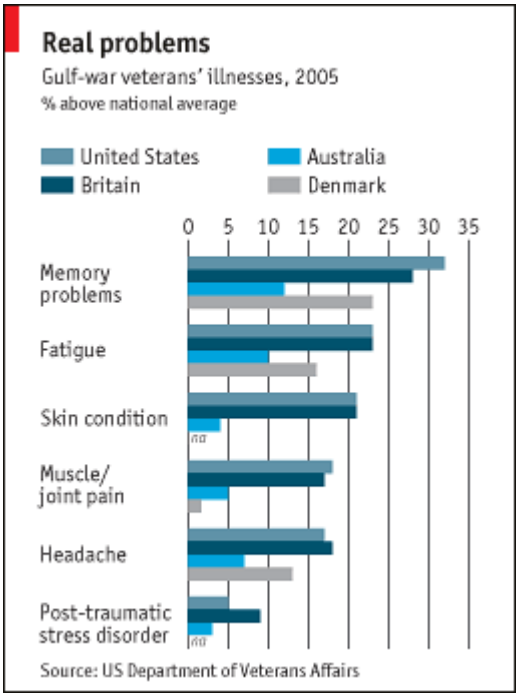
Military health

War of nerves

Mar 13th 2008
From The Economist print edition

Was Gulf-war syndrome caused by chemical poisoning?

ONE of the lingering uncertainties from the first Gulf war is whether, and if so how, it caused chronic health problems in many of those who took part. Symptoms routinely reported in veterans include fatigue, muscle or joint pain, altered mood and sleeping patterns, and skin and memory problems (see chart). Those who went to war were far more likely to suffer such symptoms than those who stayed at home, or were deployed in other places.



Epidemiological studies have shown that 26-32% of personnel who were deployed in the Persian Gulf are ill. This figure is calculated by subtracting the fraction of non-deployed personnel who have suffered similar symptoms, but it could understate the numbers, because troops sent to war may have been in better health than those who remained at home. In any case, it means 175,000 to 210,000 veterans suffer from chronic ill health.

Speculation over the possible cause of these ailments has included fine particles from depleted-uranium weapons, the side effects from an anthrax vaccine, pollution from burning oil wells, infectious diseases and chemical weapons. Psychological stress has also been suggested, even though the conflict was short.

In recent years evidence has begun to implicate exposure to a class of chemicals known as acetylcholinesterase inhibitors. This week Beatrice Alexandra Golomb, a medical researcher at the University of California San Diego, lends her support to this theory. Her review in the *Proceedings of the National Academy of Sciences* looks at the findings of over 100 studies on Gulf-war illnesses.

Acetylcholinesterase inhibitors, or AChEis, help to regulate the neurotransmitter acetylcholine—one of the chemicals that cause neurons to fire. The presence of AChEis causes the neurotransmitter to hang around and fire excessively, and therefore can cause abnormal brain function and uncontrolled muscle action. AChEis are found in pesticides that were used to protect soldiers against sand flies and other insects, and in the pyridostigmine bromide pills given to soldiers as part of a pre-treatment against nerve agents. In addition, AChEis are also found in sarin, a nerve gas released into the atmosphere when American forces fired rockets at the Khamisiyah munitions depot.

Dr Golomb says that many studies have found that exposure to AChEis is linked to the kind of chronic symptoms that the sick veterans report. Furthermore, she points to evidence that the more someone is exposed to these chemicals the graver their future sickness tends to be. This, she argues, provides even stronger evidence of a link.

One study modelled the amount of exposure to organophosphates (another kind of AChEi) received by veterans and found that higher estimates of exposure are associated with greater losses of the brain's white matter. Another study found that among veterans, those who were sick were more likely to have a genetic variation that means their bodies are less able to detoxify AChEis. Finally, there is a study of veterans given pyridostigmine bromide pills. Separate studies of American and Australian Gulf-war veterans show that the more pills veterans took, the worse their health is today.

Dr Golomb adds that patients with a low level of occupational exposure to acetylcholinesterase inhibitors in agriculture—for example through sheep-dipping or work in greenhouses—report symptoms that mirror

those of sick veterans. Taken together, she argues, the evidence suggests that AChEis do have a role in the chronic illnesses experienced by many veterans.

This may encourage sick veterans that a cause of their suffering could finally be found, but Simon Wessely, a professor at the Institute of Psychiatry's centre for military health research, is sceptical. He says the review does not contain new work and is an “opinion piece that continues a line of argument Dr Golomb has put forward for some time”. He points out that independent and authoritative bodies have reviewed exactly the same literature but come to different conclusions. “The truth is, after 16 years, and the initial delays in commissioning the appropriate research, it is unlikely that we will ever fill in the pieces of this particular jigsaw.”

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Cell therapy

No knee-jerk reaction

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From The Economist print edition

An innovative way to fix knees appears to provide lasting benefits

FOR centuries, healers have had high hopes for cell therapy. Various scientists and courtiers since the days of Louis XIV tried infusing those who were ailing with tissue from healthy humans or animals. In 1912 German doctors attempted to treat children who had underactive thyroids with normal thyroid cells, but to little avail. Advances in medicine now offer greater promise for the technique, especially as Carticel implants, which in 1997 became the first cell therapy to be given approval in America, show signs of providing long-term benefits.

Over 14,000 patients in America have been treated with Carticel, which uses the patient's own cartilage cells to repair damaged knees. Genzyme, an American biotechnology firm which developed the therapy, believes such treatments could become more mainstream after the results of a trial were unveiled at this week's meeting of the American Academy of Orthopaedic Surgeons.

Fixing damaged knees is tricky because the form of cartilage found in the joints does not easily regenerate and in some cases total joint replacement is the only option. However, if the patient is relatively healthy and young, and the damage is not extreme, they have found that cell therapy can work well.

Genzyme's approach takes a small sample of healthy cartilage cells from the damaged knee and uses them to grow millions more cells in a laboratory. The doctors then insert the new cells. In most cases, the implanted cells grow without rejection, since they share an identity with nearby cells. The trial showed that almost a decade after the initial surgery, nearly 90% of the patients who had shown an early positive response to Carticel (about three-quarters of the total) still enjoyed those benefits.

This enduring success could silence critics who grouse that the costs of the approach are not justified by the benefits. Allen Anderson, an orthopaedic surgeon involved with the study, believes evidence of durability will help to expand the use of cell therapy, taking it from being an expensive niche approach towards one with economies of scale. In time, reckons Dr Anderson, therapies may even advance to the point where “we can put a gene into a virus, inject it into the knee, and let it heal itself.”

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Pest control

The year of the no-rats?

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From The Economist print edition

Matching DNA to behaviour may produce a better form of pest control

TO PEOPLE in rich countries, rats belong in stories. Urban myth suggests you are never more than a few metres from one, but even if that is true, they rarely show their snouts. In poorer parts of the world, though, rats are still an intrusive pest. According to Grant Singleton, a biologist at the International Rice Research Institute in Manila, rats consume 5–10% of Asia's rice crop. In some places, that figure is as high as 30%. On top of this, rats carry disease. The most famous of these is plague—but you would notice soon enough if you caught typhus, leptospirosis or any one of several others.

The rats in South-East Asia are mainly black rats—the sort that were common in Europe until the brown, or Norwegian, rat displaced them three centuries ago. Asia's black rats have proved hard to control, in part because their behaviour has been unpredictable. If people do not know where to put the traps or lay poison, they risk killing their own livestock while the rats tuck in. And that is what has been happening. Asian rat-control programmes have usually been a flop.

Ken Aplin, a rat biologist at Australia's Commonwealth Scientific and Industrial Research Organisation, thinks he knows why. He has celebrated the Year of the Rat by showing that there are more types of them than was previously realised. That genetic diversity probably explains their unpredictable behaviour.

Dr Aplin analysed the DNA of 170 black rats from 32 countries. He concluded that the black rat originated in South-East Asia about 1m years ago. However, far from being a single species, it has split into six lines, one of which colonised India and the Middle East, and then spread to Europe at the dawn of agriculture about 10,000 years ago. This group, the *Rattus rattus* identified by Linnaeus when he started to classify the natural world, later hit Africa, the Americas and Australia, arriving on the ships of European colonists.

The other five groups, however, stayed at home—or, if they wandered at all, went only as far as islands in the Pacific. These animals all look much the same, but they behave differently from one another. And that observation, according to Dr Singleton, could lay the foundations for “surgical strikes” on the animal. If particular behaviour patterns can indeed be matched to particular genetic groups, pest managers will be able to use genetic fingerprinting to work out the best strategy to combat the rats on their patches.

Dr Singleton has noticed, for example, that some rats have reproductive cycles which are synchronised to rice-crop cycles. These animals start breeding during the early stage of grain development. Pest managers could therefore encourage people to launch pre-emptive strikes against them by organising intensive trapping campaigns at the right moment. Other strains of rat, which can invade villages, have a more uniform breeding pattern throughout the year.

Different strains of rat breed in different places. Some nest in irrigation channels. That means their burrows could be flooded when they are breeding. To Dr Singleton's surprise, one group nests in trees. At least they haven't evolved wings—yet.

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Pester power

Sob story

Mar 13th 2008
From The Economist print edition

Parents can make things worse

AS THE parents of young children know all too well, it is the squeaky wheel that gets oiled. In species such as dogs, cats, seals, birds, humans and even burying beetles, infants know that the way to get what they want is to make a fuss. (The burying beetles tap their parents' mandibles.)

For a long time such signals have been considered honest—at least by childless zoologists. The more noise an infant makes, the hungrier it is. However, Matthew Bell, a zoologist at Cambridge University, now suspects that a degree of dishonesty and manipulation may be involved.

There is, he says, a conflict of interest between parents and offspring, with offspring frequently wanting more resources than the parents would readily provide. But because the parents do not know for sure how hungry their child is, they are liable to manipulation.

Dr Bell decided to investigate this further in banded mongooses in western Uganda. Mongooses breed communally and individual pups form stable relationships with “escort” animals. Although not parents, the pups receive nearly all their food from the escorts for up to three months. Because begging has a cost in terms of energy, Dr Bell speculated that the amount of noise pups make should depend on the degree to which they think they will get a return on their work. Pups are less likely to make a noise if they think the returns will be low—for example, with carers that are stingy or in bad condition and thus have less food to spare.

Dr Bell conducted a series of experiments, such as depriving infants of food for a time before returning them to their carers. Dr Bell confirmed that pups made more noise with generous carers, and less with carers that were stingy or likely to be so.

He thinks the findings are more broadly applicable. In human infants, there is the same kind of “information battle”, in which parents try to understand the cues that accurately convey information about what their offspring needs, versus what they can get away with. Parents of over-fussy babies, or tantrum-prone children, will not be pleased to discover it is their very attentiveness that is making matters worse. It is painful to acknowledge, but marketers were right all along: pester power works.

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Invading Iraq

Eyeing the wages of war

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From The Economist print edition

AP

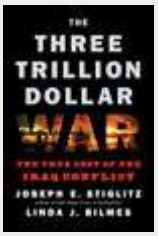
Two economists take an unflinching look at the costs of invading Iraq

SUPPOSE that, five years ago, George Bush had asked every American household to stump up $25,000 to pay for an imminent war on Iraq. How would they have responded?

That money, suitably husbanded, would have paid for arming, provisioning and remunerating the troops; treating the wounded; and restoring the army's strength in the aftermath. It would have paid just compensation for the death and injury of American servicemen and contractors, and it would have covered America's outlays on reconstruction. It would also have allowed America to subsidise the price of oil by $10 a barrel—offsetting the disruption to Iraq's supply.

Mr Bush never asked, of course. But this hefty sum is nonetheless just part of the toll the war may take on America by the time it is over, according to a new book by Joseph Stiglitz, a Nobel prize-winner in economics, and Linda Bilmes, a budget and public finance expert at Harvard's Kennedy School of Government.

The Three Trillion Dollar War: The True Cost of the Iraq Conflict
By Joseph E. Stiglitz and Linda J. Bilmes



Norton; 311 pages; $22.95. Allen Lane; £20

Buy it at
Amazon.com
Amazon.co.uk

How do the authors arrive at the $3 trillion figure of the title, and the still bigger numbers they report inside? To the administration's own requests for money they add other costs to the taxpayer that either appear elsewhere in the budget (such as the bonuses required to attract recruits put off by the war) or do not yet appear at all (such as the future disability claims of wounded veterans). They put a dollar figure on the American lives lost or damaged by debilitating injury. And they also estimate the damage the war has done to the American economy, by raising the price of oil and diverting spending from domestic investment to foreign adventures.

Along the way, they accuse the administration of both mortgaging the nation's future and short-changing the troops and of deceiving the public and deluding itself. The administration still treats a five-year war as an unforeseen contingency to be paid for by an extra, emergency appropriation outside its regular budget request. And it has indulged in false economies that shave the cash requirements of the war today—by, for example, hesitating to purchase mine-resistant vehicles—only to store up much bigger

burdens for the future, such as the cost of caring for veterans injured by roadside bombs.

Critics have questioned some of the authors' estimates, since these were first rehearsed in an academic paper in 2006. The head of the non-partisan Congressional Budget Office, for example, thinks that paper overestimated the burden of brain injuries, overstated the cost of replacing munitions and equipment, and misattributed other military expenses. But the authors have taken pains to answer those quibbles, and they disclose their sources so that readers can add or subtract as they see fit.

They go on to pursue the war's trail through every twist and turn of the macroeconomic labyrinth. Here, their reasoning is a bit too ingenious. They argue, for example, that the government's spending abroad prevented it from giving America a needed fiscal boost at home. Even if you believe America has suffered from a shortfall of demand in the past five years, surely the blame cannot be pinned on the Iraq war. It must lie instead with the Federal Reserve, which is supposed to maintain full employment as best it can.

Indeed, what is remarkable is how small a macroeconomic price America has paid for its adventure. Not only has the war been financed by borrowing rather than taxes, but also the borrowing has been dirt cheap. Neo-imperialists worry that America has the responsibilities of a global superpower, but an electorate unwilling to shoulder them. For better or worse, though, the combination of volunteer soldiers, hired guns and Asian creditors has lightened the load.

Unlike some other economists, Mr Stiglitz and Ms Bilmes do not weigh the cost of the war against the obvious counterfactual: the cost of containing Saddam Hussein. (They do subtract the cost of enforcing the no-fly zones over the country). Keeping a big force in the region—big enough to cow the dictator into letting weapons inspectors do their job—would not have been cheap, although with hindsight the strategy looks like a bargain. Nor do they pay much attention to the benefits of the invasion, however meagre. For example, the world now knows for sure that Saddam will never lay his hands on weapons of mass destruction. That knowledge may not be worth $3 trillion. But it is surely worth something.

The book mixes the patience of an auditor with the passion of a polemicist; it combines forensic intelligence with prosecutorial zeal. This reviewer responded more to its quieter virtues. As the authors say, the book is not just about the big number on the cover. More importantly, “by examining the costs, we come to understand better the implications of the war.”

Great powers almost never pay for their wars up front. Even in America's war of independence, the revolutionaries printed money to finance their campaign. But a government contemplating war should surely provide a credible advance estimate of the final bill, akin to what Mr Stiglitz and Ms Bilmes have done. If they cannot, it is a good sign they have not fully weighed the implications of their venture. If so, perhaps they should not undertake it at all.

The Three Trillion Dollar War: The True Cost of the Iraq Conflict.
By Joseph E. Stiglitz and Linda J. Bilmes.
Norton; 311 pages; $22.95. Allen Lane; £20

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Irrational fear

No good at risk

Mar 13th 2008
From The Economist print edition

THE official death toll from the September 11th terrorist attacks in 2001 was 2,974. But in 2002 America's death toll on the roads grew by more than 1,500—casualties of the terrorism-inspired exodus from safe aeroplanes to dangerous motor cars. A swan washes up on a British shore, dead from bird flu, and the press panics, while the 3,000 people who die every year on the country's roads (13 times the number of people who have ever died from bird flu) go largely unremarked.

Human beings are notoriously bad at dealing with risk. Two new books explore why, and investigate the effects that misunderstanding risks can have on public policy. The first, an excellent work by a Canadian writer, Dan Gardner, is a broad meditation on the nature of risk, beginning with a psychological explanation for why people find it so difficult to cope. Mr Gardner analyses everything from the media's predilection for irrational scare stories to the cynical use of fear by politicians pushing a particular agenda.

His take on terrorism in the book's penultimate chapter is refreshing. He punctures ludicrous claims that “this conflict is a fight to save the civilised world” (George Bush) or that terrorism's threat is “existential” (Tony Blair), and expertly deflates the more self-serving statements made by the terrorism industry that has mushroomed since the September 11th attacks.

Mr Gardner never falls into the trap of becoming frustrated and embittered by the waste and needless worry that he is documenting. A personal anecdote about an unwise foray into a Nigerian slum in search of a stolen wallet disposes of the idea that the author is immune to the foibles he describes. What could easily have been a catalogue of misgovernance and stupidity instead becomes a cheery corrective to modern paranoia.

The second book, by Simon Briscoe, a journalist on the *Financial Times*, and Hugh Aldersey-Williams, a writer, aims to be more focused. It forsakes a general treatment of risk for a rigorous analysis of several dozen of the most popular media scare stories, ranging from family breakdown and over-inflated housing markets to climate change, genetically modified foods and unsafe vaccines.

The book, however, feels rushed, which is a shame because Mr Briscoe is something of a statistician. Many chapters come to no definite conclusion on the magnitude of the risk they analyse, instead simply presenting a mass of evidence and leaving it for the reader to decide. A gimmicky scoring system gives each story marks out of five in three separate categories of “panic”, “risk” and “personal empowerment”, but nowhere is it explained exactly what the scores mean. As a guide to which risks to fear and which to ignore, it is not much use.

The chief paradox in both books is that anybody alive today faces far fewer risks than at any time in human history. Diseases that killed millions are found only in medical textbooks in large swathes of the world; life expectancy has risen hugely over the past two centuries; and, despite misty nostalgia for better times, most societies are safer today than even 50 years ago. Yet fear and panic have not disappeared—instead of worrying about polio, famine or war, people fret about wrinkles, paedophiles and virtually undetectable levels of industrial chemicals in food. Both books try to correct this irrational view of the world, reassuring readers that most of the hobgoblins by which they are menaced are unnecessarily frightening.

Risk: The Science and Politics of Fear
By Dan Gardner

Virgin; 368 pages; £17.99

Buy it at Amazon.co.uk

Panicology: Killer Birds!! Alien Abductors!! Rising Sea Levels!!—Two Statisticians Explain What's Worth Worrying About (and What's Not) in the 21st Century
By Simon Briscoe and Hugh Aldersey-Williams

Viking; 284 pages; £18.99

Buy it at Amazon.co.uk

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New theatre

Iraq on the stage

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A drama about the Americans in Iraq is drawing eager audiences

IT IS hard to recall a time when America's invasion in Iraq inspired hope. Yet millions of Iraqis welcomed the fall of Saddam Hussein in 2003, and a precious few—often the most frustrated and educated—risked their lives to help the incoming soldiers. But the war has been unkind to the many Iraqis, translators and others, who worked closely with the American forces. They are threatened as traitors by their countrymen and then denied asylum in America. “America's failure to understand, trust, and protect its closest friends in Iraq is a small drama that contains the larger history of defeat,” wrote one of the most prescient witnesses to the war effort, George Packer, in a long article in the *New Yorker* last March.

Now Mr Packer has rewritten his reporting as a stage drama. So successful is it at portraying the chilling humanity of the Iraqis he interviewed that his play, “Betrayed”, has been playing to a full house every night. “Sometimes”, says one translator to another, “I feel like we're standing in line for a ticket, waiting to die.” That many of these lines came straight from interviews with Iraqis lends greater heft to their despair.

The play follows three fictional Iraqi translators—two men and a woman—who work in the American embassy in the Green Zone. They are all hungry for change, and keen to help the Americans bring it about. But time in the insular (and often insulting) “sensory-deprivation tank” of their Baghdad headquarters steadily erodes their hopes.

“Didn't they give you some information before you came here, sir?” asks Laith (Sevan Greene) of an American soldier. “Nobody told us a goddam thing. I should have been back in Muncie by now.” Mr Packer has said he was haunted by these Iraqi voices long after the article was published. When the Culture Project theatre proposed turning it into a play, it took Mr Packer eight months to “squeeze the journalism out” of the story and plunge deeper into the characters, making them flesh on the stage.

Directed by Pippin Parker, “Betrayed” is a rare and powerful piece of political drama, both gripping and nuanced. The theatre has just announced it will extend the run by another six weeks, ensuring these voices will continue to haunt.

“Betrayed: The Iraqis who Loved America too Much” is at the Culture Project, New York, until April 13th

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20th-century literature

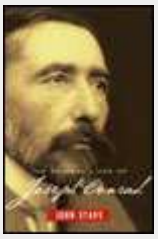
Striving for the spirit

Mar 13th 2008
From The Economist print edition

JOSEPH CONRAD'S real name—Josef Teodor Konrad Korzeniowski—seems to express all the prickliness of his character and unassimilated knobbliness of his Polish background. Conrad was always sensitive to the charge of being “a sort of freak, a bloody amazing furriner writing in English.” But even before he chose English as his language and England as his adopted home, the very idea of belonging anywhere had always been fraught.

Ukraine, where Conrad was born in 1857, and Poland, where he spent much of his youth, were phantom countries—both then part of the Russian empire. There had been a doomed Polish uprising in 1830, and there would be another in 1863. His father, a journalist, poet and translator, lived and died for the Polish nationalist cause. When Conrad was four his father was imprisoned; when he was five, the family was sent into exile. By the time he was 12, both parents were dead. For Conrad, national identity had always been an idea, a state of mind, not a fact—and Polish identity a peculiarly embattled one, a bristling redoubt of language, tradition and culture.

The Several Lives of Joseph Conrad
By John Stape



Pantheon Books; 369 pages; $30. William Heinemann; £20

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Conrad's adolescent fixation with the sea, and his subsequent career in the French and British merchant navies, can be variously interpreted—as escape, revolt, desertion, as Quixotic inspiration, or as a kind of personal test. These ideas and their psychological and moral implications run through his fiction. However, one of John Stape's objectives in writing this biography is to stick to the evidence. A Conrad expert, Mr Stape deals briskly with the myth-making, and is wary of using the fiction for biographical purposes. Where he cannot disprove something, his instincts are sceptical. It is characteristic of him, for example, that he should open one sentence with the possibility that Conrad, in command of a cargo ship, may “or may not” have left port with a broken heart—and end it with the assurance that he succeeded in “turning a profit on dealings in potatoes”.

Mr Stape's desire to strip out the myths and not to add more is to be admired, as is his wish to avoid “distorting angles”. But he is dry. Conrad said that the artist's task was to “make you feel...to make you see.” Biographers can't all be artists, but something of that spirit should inform their task. With so much summary and paraphrase, such constraint on using the works themselves (this is not a critical biography, he says), one wonders who Mr Stape thought was his intended readership.

Admittedly, Conrad was difficult to know—“always calculatingly guarded”, Mr Stape says, “even when appearing to wear his heart on his sleeve.” What comes across vividly is his gloom, the illnesses and depressions compounded by the misfortunes of his increasingly obese and disabled wife. That, and the debts, the tortures of writing, of juggling his audiences (high art by day and “bosh”, as he called it, or sea-tales, by night), of blocks, distractions and deadlines. And yet, about half- way through the book there begin to be wonderful glimpses of him through the eyes of his friends: vital, voluble, gesticulating, nervous and excitable, his English heavily accented, his face leathery, piratical. Bertrand Russell was dazzled by him; T.S. Eliot called him a “Grand Seigneur, the grandest I have ever met.” At last one can see him—but one longs to get more of a feel for this kind of Conrad too.

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By John Stape.
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AIDS in South Africa

A testing journey

Mar 13th 2008
From The Economist print edition

Get article background

WITH effective drugs now increasingly available to combat AIDS, why do so many South Africans still choose to stay at home and die? Sizwe, a 29-year-old from the rural district of Lusikisiki in the Eastern Cape, lives close to what was one of the country's most successful treatment programmes, administered by Médecins Sans Frontières (MSF), a non-governmental organisation. Yet Sizwe refuses to have himself tested, in spite of losing his best friend to AIDS, having access to medication and watching those on treatment recover their health.

Jonny Steinberg, a journalist, spent months looking at the world through Sizwe's eyes, trying to understand what prevents him and millions of other South Africans from knowing their status and, if necessary, seeking treatment.

For MSF's Hermann Reuter, a doctor, the solution lies in drugs being available nearby, a good service provided by nurses and lay people in clinics—not doctors in hospitals—and a network of activist patients putting pressure on the public sector to deliver. But Mr Steinberg remains sceptical. “When I spoke to [Hermann Reuter] about my travels with Sizwe, it sometimes seemed that I was bringing news from another planet, that Hermann himself lived in a charmed circle of activists and converts,” he remarks.

Sizwe's Test: A Young Man's Journey Through Africa's AIDS Epidemic
By Jonny Steinberg

Simon & Schuster; 368 pages; $26. To be published in Britain as "Three-Letter Plague" by Jonathan Cape in the autumn

Buy it at
Amazon.com
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Sizwe's reluctance runs deep. “Some people have maybe sent a demon to have sex with me: a demon with HIV. That is why I am scared to test,” he says. The young man overcame his dirt-poor upbringing and now owns his village's only shop. But he has to manage his modest success carefully for fear of unleashing his neighbours' envy and hostility. This is no place for the weak: some of the village youngsters bring in guns to rob elders they have known all their lives. Sizwe's life and success feel precarious, and who knows what testing positive might unleash?

A distrust of white doctors also feeds the fear of testing. When MSF arrived in the area, explains a volunteer, people believed that the white doctor had come to kill people with his needle and blood test. “They believed AIDS was caused by politics, by white people.” President Thabo Mbeki's dissident views on AIDS and antiretroviral drugs reflect similar fears. A local government councillor tells Mr Steinberg that he does not trust the drugs because they are not African. “Mbeki did not fabricate the old man's paranoia,” remarks the author, “but he did draw it to the surface of South Africa's political culture.”

For Sizwe, who is about to marry the mother of his son, testing positive would also destroy a future constructed on the remains of a traditional culture that commands marriage and heirs. The young man argues that knowing that his blood is “dirty”, with a virus that can be tamed but not killed, would push him to a fast death.

In an elegant and accessible style, Mr Steinberg gives human faces and voices to fear, shame, stigma and a public health system that is failing its people, while placing it all in a broader context. His book is essential to understanding the visible and invisible barriers that undermine the fight against AIDS in South Africa.

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Chinese art in Florence

Dainty, ferocious and extravagant

Mar 13th 2008 | FLORENCE
From The Economist print edition

suebond.co.uk

Small but perfectly formed

Italy's Renaissance jewel is a fine setting for treasures from China's golden age

IT HAS already been billed as Renaissance squared—China's golden age meets Italy's era of glory. But this exhibition is far more ambitious than that.

More than 200 Chinese paintings, sculptures and works of art—among them pieces never before seen in the West—are on display at the magnificent arcaded Palazzo Strozzi in the centre of Florence. Its focus is the art of the Tang dynasty, the high point of Chinese cosmopolitan culture.

The Tang emperors ruled from 618 to 907, but the earliest pieces in the show date from 700 years before that. Sabrina Rastelli, the curator, who lectures in Chinese art at the University of Venice, has chosen to include these and other works from the period before the Tang came to power to illustrate how a traditional interpretation of Chinese history is gradually being revised.

It has long been believed that the centuries between the Han and Tang dynasties were China's Dark Ages—a time as devoid of cultural merit as Arabia's Empty Quarter is of trees. Ms Rastelli is among the scholars now arguing that there existed innovators during those volatile, fragmented centuries on whose work Tang artists were able to build.

By the eighth century, the Silk Road linking China with the Mediterranean and the maritime routes around China itself had brought to its capital Chang'an (now Xian, and then the biggest city in the world) dancers and musicians from central Asia; long-legged horses; Persian, Arab, Turkish and Jewish merchants; and acrobats and boxers from Java.

During its 300 years of relative peace, works of extraordinary elegance, grace and power were made. A solitary, 36.2cm (14.3-inch) pottery Tang woman wearing a hooped head-dress is especially seductive. There are literally dozens of other memorable Tang objects—some dainty, others ferocious, extravagant or meditative—beginning with a four-tonne, smiling Buddha in the palace courtyard.

Buddhism reached China from India in the first century but only in the fourth—after the collapse of the Han—did it spread rapidly through the country. The growth of Buddhist iconography in the Tang era is a persuasive part of the argument that China's golden age did not rise suddenly from the ashes of the chaos preceding it, but was built on the inventions and creations of the tumultuous years before.

One charming and effective illustration of this is a display of several groups of small, ceramic figures. All were excavated; none is more than 30cm high. The earliest group, celadon-glazed in the mid-third

century, consists of four attendants about 15cm high, flanking a seated musician. Two ladies with large heads and sculptural hats follow. They are from the late third century. Next there are four seated female musicians, dating from the late fourth century, each holding her instrument and wearing identical blunt bobs. Two female attendants from the early fifth century are slightly more elaborate, the clay here incised with details of clothing and hairdos. Finally there are four Tang dancers who seem to be swaying to a tune. Suddenly all the other figures seem static and mute. Visitors need no words to understand that for many centuries craftsmen were drawn to similar themes, handling them with progressive sophistication until in the Tang dynasty they leapt up to become art.

Romeo Gigli, an Italian fashion designer, installed the show. Many of the three-dimensional works are displayed on a series of large, amorphously shaped islands that resemble flat-topped, pale yellow sand dunes. Initially this seems odd. Almost everything on view comes from tombs, Buddhist cave monasteries or buried treasure. But the sandy colour suits the muted colours of many of the objects. The labelling is also well done. Best of all, there are none of the glass cases that can be such a deadening barrier to viewers.

Wall paintings, of interest because so little Tang painting on silk survives, are among the show's highlights. Unlike frescoes, the ground applied to walls was dry when Tang painters set to work. (The nature of this ground is still not known.) Some are amusing, like the animated picture of a woman playfully teasing an indignant goose. One of the most moving is a larger painting of two grooms struggling to lead a beautiful white horse who does not want to move. It was found at the entrance to the tomb of Precious Consort Wei, a great horsewoman. Ms Rastelli rightly describes it as a work of “stupefying quality”.

This exhibition is part of an ongoing series of major loan shows through which China is educating foreigners about its culture. These are now so numerous that the Chinese authorities have introduced a rationing system for lending artefacts from their museums. National treasures are never loaned; everything else is categorised according to its perceived importance. The proportion of the best work that is given to any one show is limited to around 20%. Happily, the quality of art in this exhibition is far higher than this system of allocation suggests.

“China: At the Court of the Emperors—Unknown Masterpieces from Han Tradition to Tang Elegance” is at Palazzo Strozzi, Florence, until June 8th

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Gary Gygax

Mar 13th 2008
From The Economist print edition

Ernest Gary Gygax, a dungeon master, died on March 4th, aged 69

thomashandkeefe.com

FOR most people, “role-playing” conjures up dreary afternoons at management retreats, pretending to be an irate customer or a difficult employee. But if you are under 45 and possibly something of a nerd, more evocative memories may surface. You are Jozan, adventurer-cleric of the sun-god Pelor, travelling the world of Greyhawk, battling orcs and evil wizards, righting wrongs and seeking treasure—at least until you and your friends run out of beer and crisps and stagger off to bed. This is Dungeons & Dragons (D&D), the first of the role-playing games and the reason for thousands of misspent youths.

Gary Gygax was perfectly equipped to bring this fantastic world to basements and dining-room tables all over the world. As a boy he was fascinated by games of all sorts, from pinochle to chess. His father, a violinist, read him countless pulp novels featuring dragons, wizards and elves. Even the family name, he once said, had fantastic origins, proving that the Gygaxes were descended from Goliath.

An interest in history lured him into war-gaming, the re-enactment of historical battles with miniature men and a simple rulebook. For several months the members of the Lake Geneva Tactical Studies Association (a grand name for a group of friends that met in Mr Gygax's basement) entertained themselves by re-fighting old battles. One day, to spice things up, Mr Gygax turned a plastic dinosaur into a dragon and mixed in wizards and trolls among the men-at-arms.

His fellow-players loved it. Abandoning a career in insurance and in collaboration with Dave Arneson, a fellow gamer, Mr Gygax refined his ideas. From large groups of combatants he moved to individual characters, cooking up rules for magic spells and creating a menagerie of monsters for his heroes to fight.

Manufacturers, when he approached them, were less keen. There was no board and no way to win—and those weirdly shaped dice looked confusing. So Mr Gygax and his colleagues set up their own firm, Tactical Studies Rules (TSR). Business was brisk, and D&D became an underground hit on campuses around the world. A moral panic about devil-worship only drove sales higher.

As a creative endeavour, Mr Gygax's invented world was deeply unoriginal: he borrowed shamelessly from authors such as Jack Vance, Robert E. Howard and J. R. R. Tolkien. But rather than merely describing these worlds, as their authors had done, his invention—a blend of mathematics, theatre and imagination—allowed his players to live in them. Players built their alter egos by using numbers to represent characteristics such as strength, toughness and intelligence. A “games master” or “dungeon master” would create adventures and provide the opposition—an evil wizard, say, or a manipulative king. A complicated but flexible set of rules allowed players to do almost anything they liked, provided their

characters were competent. The crucial element of chance was provided by rolling the game's iconic 20-sided dice.

Triumph of the nerds

As time went on, Mr Gygax became more remote from his creation. His company, having thrown him out, was sold in 1997 to Wizards of the Coast, an upstart fantasy publisher that made sweeping changes to the rules. Mr Gygax disliked that, worrying that the focus was shifting to mathematical questions of maximising players' power. He wrote several new games, working six-day weeks even in his 60s, attending conventions, replying to fan mail and taking time off only for his beloved American football. But none of his new games matched D&D's success.

The game was spreading beyond basements, particularly influencing the nascent computer-games industry. Mr Gygax didn't like that either; he thought computer graphics cheapened the experience by substituting an artist's imagination for the player's. And while computers were ideal for streamlining tedious dice rolls and arithmetic, those, for him, were never the point. He considered role-playing a social thing, a form of group storytelling. Nevertheless, his impact was enormous. One gaming website voted him the joint 18th-most-influential person in computer games, quite an honour for someone who hardly played them.

His influence extends even to people who have never conjured a fireball in anger. Today's world is a nerd's world, and Mr Gygax did much to shape it. Blockbuster fantasy films like “The Lord of the Rings” are produced and directed by people who grew up with the game. Computer games are part of mainstream culture; “World of Warcraft”, an internet-based D&D clone, boasts 10m subscribers. Many of the people who built the internet (and their fortunes) spent their childhoods playing the game. The entry for D&D on Wikipedia is twice the length of the article on Proust.

But despite its influence on mainstream culture, D&D as a pastime is still a minority pursuit. Its fans perversely enjoy the opprobrium it still attracts, as well as its deeply cryptic side. “Gary Gygax Fails Fortitude Save” read one online epitaph, intelligible only to the initiated. And as for the qualities he gave his own D&D characters, Mr Gygax would never say.

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Overview

Mar 13th 2008
From The Economist print edition

Oil prices reached a new record on March 12th, when the price of a barrel of West Texas Intermediate rose above $110.

American employers, excluding farms, cut 63,000 workers from their payrolls in February, the largest decline in almost five years. The unemployment rate nevertheless edged down from 4.9% to 4.8%, as many jobseekers gave up looking for work. America's trade deficit widened slightly, from $57.9 billion to $58.2 billion in January.

Consumer prices in **China** rose by 8.7% in the year to February, the highest rate for more than 12 years. Food prices were 23.3% higher than a year earlier.

Industrial production in the **euro area** rose by 0.9% in January, leaving it 3.8% higher than a year earlier.

Japan's index of household consumer confidence fell by 3.7% in February, reaching its lowest level since March 2003.

Consumer-price inflation in **Sweden** edged down from 3.2% to 3.1% in February.

In **Norway** consumer prices rose by 3.7% in the year to February.

In the **Czech Republic** GDP rose by 1.7% in the fourth quarter, leaving it 6.6% higher than a year earlier.

India's industrial production rose by 5.3% in the year to January.

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Output, prices and jobs

Mar 13th 2008
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2008†	2009†	latest	latest	year ago	2008†	rate‡, %
United States	+2.5 Q4	+0.6	+1.5	+2.2	+2.3 Jan	+4.3 Jan	+2.1	+3.2	4.8 Feb
Japan	+2.0 Q4	+3.5	+1.4	+1.6	+2.2 Jan	+0.7 Jan	nil	+0.6	3.8 Jan
China	+11.2 Q4	na	+9.8	+9.0	+12.6 Feb	+8.7 Feb	+2.7	+4.5	9.5 2007
Britain	+2.9 Q4	+2.3	+1.9	+2.0	+0.4 Jan	+2.2 Jan§	+2.7	+2.4	5.2 Dec††
Canada	+2.9 Q4	+0.8	+1.7	+2.2	−1.3 Dec	+2.2 Jan	+1.1	+1.9	5.8 Feb
Euro area	+2.2 Q4	+1.6	+1.7	+1.8	+3.8 Jan	+3.2 Feb	+1.8	+2.5	7.1 Jan
Austria	+3.0 Q4	+2.3	+2.5	+2.3	+3.4 Dec	+3.3 Jan	+1.6	+2.1	4.2 Jan
Belgium	+2.4 Q4	+2.0	+1.9	+1.9	−1.9 Dec	+3.6 Feb	+1.8	+2.4	10.9 Jan‡‡
France	+2.0 Q4	+1.2	+1.6	+1.7	+2.7 Jan	+2.8 Feb	+1.0	+2.2	7.5 Q4§§
Germany	+1.8 Q4	+1.1	+1.7	+1.9	+7.0 Jan	+2.8 Feb	−6.0	+2.1	8.0 Feb
Greece	+3.6 Q4	+2.8	+2.4	+2.6	+1.6 Jan	+4.4 Feb	+2.7	+3.3	8.9 Dec
Italy	+1.9 Q3	+1.7	+1.0	+1.4	+0.5 Jan	+2.9 Feb	+1.8	+2.4	5.9 Q3
Netherlands	+4.4 Q4	+4.7	+2.3	+2.1	+2.0 Jan	+2.2 Feb	+1.5	+2.0	4.1 Jan††
Spain	+3.5 Q4	+3.2	+2.4	+2.1	−0.2 Jan	+4.4 Feb	+2.4	+3.5	8.8 Jan
Czech Republic	+6.6 Q4	+7.0	+4.7	+5.4	+9.3 Jan	+7.5 Feb	+1.5	+6.5	5.9 Feb
Denmark	+2.0 Q4	+1.8	+1.6	+1.8	−1.8 Jan	+3.1 Feb	+1.9	+2.2	2.1 Jan
Hungary	+0.7 Q4	+0.8	+2.5	+3.6	+6.6 Jan	+6.9 Feb	+8.8	+5.7	8.1 Jan††
Norway	+5.2 Q4	+5.2	+2.9	+2.6	−1.4 Jan	+3.7 Feb	+0.8	+3.1	2.4 Dec††
Poland	+6.1 Q4	na	+5.1	+4.3	+10.8 Jan	+4.3 Jan	+1.6	+3.6	11.7 Jan‡‡
Russia	+7.7 Q3	na	+7.0	+6.0	+4.8 Jan	+12.7 Feb	+7.6	+12.5	5.7 Jan‡‡
Sweden	+2.8 Q4	+3.1	+2.6	+2.5	+3.8 Jan	+3.1 Feb	+2.0	+2.6	6.1 Feb‡‡
Switzerland	+3.6 Q4	+4.2	+2.0	+1.9	+10.7 Q3	+2.4 Feb	nil	+1.6	2.5 Jan
Turkey	+1.5 Q3	na	+3.7	+5.4	−1.4 Dec	+9.1 Feb	+10.2	+8.4	10.1 Q4‡‡
Australia	+3.9 Q4	+2.4	+3.3	+3.2	+1.6 Q3	+3.0 Q4	+3.3	+3.1	4.0 Feb
Hong Kong	+6.7 Q4	+6.6	+4.0	+4.6	−2.1 Q3	+3.3 Jan	+2.0	+4.0	3.4 Jan††
India	+8.4 Q4	na	+7.8	+7.2	+5.3 Jan	+5.5 Jan	+6.7	+5.8	7.2 2007
Indonesia	+6.3 Q4	na	+6.1	+5.7	+1.6 Dec	+7.4 Feb	+6.3	+6.4	9.8 Feb
Malaysia	+7.3 Q4	na	+5.5	+5.7	+7.0 Jan	+2.3 Jan	+3.2	+2.8	3.1 Q3
Pakistan	+7.0 2007**	na	+5.4	+5.4	−4.1 Dec	+11.3 Feb	+7.4	+7.9	6.2 2006
Singapore	+5.4 Q4	−4.8	+4.5	+4.7	+6.9 Jan	+6.6 Jan	+0.2	+3.0	1.6 Q4
South Korea	+5.5 Q4	+6.3	+4.4	+4.4	+11.8 Jan	+3.6 Feb	+2.2	+2.9	3.0 Jan
Taiwan	+6.4 Q4	na	+4.5	+4.3	+12.3 Jan	+3.9 Feb	−2.2	+1.7	4.0 Jan
Thailand	+5.7 Q4	+7.3	+4.7	+4.0	+12.5 Jan	+5.4 Feb	+2.3	+3.2	0.8 Dec
Argentina	+8.7 Q3	+11.7	+5.5	+4.5	+12.9 Jan	+8.4 Feb	+9.6	+11.4	7.5 Q4‡‡
Brazil	+6.2 Q4	+6.6	+4.3	+4.0	+8.5 Jan	+4.6 Feb	+3.0	+4.5	8.0 Jan‡‡
Chile	+4.1 Q3	−2.5	+4.0	+4.6	+4.4 Jan	+8.1 Feb	+2.7	+5.9	7.2 Jan†††‡‡
Colombia	+6.6 Q3	+6.9	+4.5	+4.0	+8.7 Dec	+6.4 Feb	+5.3	+5.3	9.9 Dec‡‡
Mexico	+3.8 Q4	+3.0	+1.9	+3.0	+1.3 Dec	+3.7 Feb	+4.1	+4.1	4.1 Jan‡‡
Venezuela	+8.5 Q4	na	+5.5	+4.6	+7.2 Oct	+25.2 Feb	+20.4	+27.8	6.7 Q4‡‡
Egypt	+8.1 Q4	na	+7.4	+6.9	+7.5 2007**	+12.1 Feb	+12.6	+9.8	8.8 Q3‡‡
Israel	+6.8 Q4	+6.4	+3.7	+4.2	+4.0 Dec	+3.5 Jan	+0.1	+2.8	6.8 Q4
Saudi Arabia	+4.3 2006	na	+6.0	+5.6	na	+7.0 Jan	+3.6	+7.5	na
South Africa	+4.6 Q4	+5.3	+4.2	+5.4	+1.4 Jan	+9.3 Jan	+6.0	+6.8	25.5 Mar‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	+4.5 Q4	na	+4.0	+4.3	+4.1 Jan	+11.3 Feb	+4.7	+9.0	5.3 Dec
Finland	+3.7 Q4	+3.8	+3.1	+2.8	+2.3 Jan	+3.8 Jan	+2.3	+2.0	6.4 Jan
Iceland	+4.6 Q4	+1.2	+2.0	+3.3	+7.6 2006	+6.8 Feb	+7.4	+5.0	1.0 Jan‡‡
Ireland	+4.1 Q3	+5.6	+2.4	+2.6	+0.8 Dec	+4.3 Jan	+5.2	+3.0	4.9 Jan
Latvia	+8.0 Q4	na	+5.8	+6.0	−0.1 Jan	+16.7 Feb	+7.2	+10.5	5.0 Feb
Lithuania	+7.9 Q4	−4.3	+7.2	+6.4	na	+10.8 Feb	+4.3	+7.0	4.6 Jan‡‡
Luxembourg	+5.6 Q3	+2.8	+4.3	+4.5	−1.4 Nov	+3.3 Jan	+2.3	+2.5	4.6 Jan‡‡
New Zealand	+3.4 Q3	+1.1	+2.0	+2.7	+1.3 Q3	+3.2 Q4	+2.6	+2.8	3.4 Q4
Peru	+9.9 Dec	na	+6.3	+6.7	+6.5 Dec	+4.8 Feb	+0.4	+3.7	7.0 Dec‡‡
Philippines	+7.3 Q4	+7.4	+5.4	+5.5	−1.8 Dec	+5.4 Feb	+2.6	+4.0	6.3 Q4‡‡
Portugal	+2.0 Q4	+3.0	+1.8	+2.1	−1.4 Jan	+2.9 Jan	+2.6	+2.3	7.8 Q4‡‡
Slovakia	+14.3 Q4	na	+7.5	+5.7	+8.4 Jan	+3.8 Jan	+3.0	+3.0	8.1 Jan††
Slovenia	+4.7 Q4	na	+4.6	+4.0	nil Dec	+6.5 Feb	+2.1	+4.4	7.3 Dec‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate 4.1% in Jan. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. §§New series.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

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The Economist commodity-price index

Mar 13th 2008
From The Economist print edition

The Economist commodity-price index

2000=100

	Mar 4th	Mar 11th*	% change on one month	% change on one year
Dollar index				
All items	271.9	268.3	+9.9	+40.7
Food	268.0	269.7	+10.9	+71.3
Industrials				
All	276.9	266.5	+8.7	+14.1
Nfa†	202.5	185.2	−1.1	+20.7
Metals	317.7	310.7	+12.2	+12.1
Sterling index				
All items	207.6	203.0	+7.5	+35.7
Euro index				
All items	165.0	161.8	+4.6	+21.2
Gold				
$ per oz	965.55	974.90	+6.5	+50.2
West Texas Intermediate				
$ per barrel	99.93	108.64	+17.3	+87.4

*Provisional †Non-food agriculturals.

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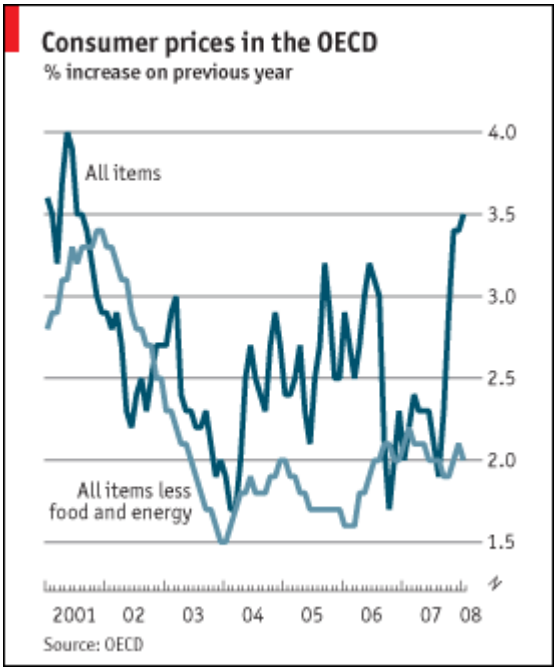
Consumer prices in the OECD

Mar 13th 2008
From The Economist print edition



A weighted average of consumer prices among OECD members increased by 3.5% in the year to January, up from 3.4% a month earlier. The last time inflation reached this level was in August 2001, when the economies of the rich world last slowed. Back then, central bankers were troubled both by headline and also by core inflation, which excludes food and energy. However this time, core inflation is growing at a modest 2%, whereas the cost of energy and food are sharply higher. This is primarily the result of strong demand for commodities in emerging markets. That may pose a problem for rich-world inflation fighters, because price pressures will not necessarily subside as their growth slows.

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Trade, exchange rates, budget balances and interest rates

Mar 13th 2008
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Mar 12th	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−819.2 Jan	−752.4 Q3	−4.7	–	–	−2.4	2.52	3.48
Japan	+105.6 Dec	+214.7 Jan	+4.7	102	116	−2.7	0.75	1.30
China	+250.0 Feb	+249.9 2006	+10.4	7.10	7.74	0.2	4.50	4.38
Britain	−177.2 Jan	−129.4 Q3	−3.8	0.49	0.52	−3.2	5.76	4.42
Canada	+44.9 Jan	+12.5 Q4	+0.4	0.99	1.18	0.6	2.35	3.62
Euro area	+39.0 Dec	+18.9 Dec	−0.1	0.65	0.76	−1.0	4.61	3.79
Austria	+0.3 Dec	+11.3 Q3	+2.7	0.65	0.76	−0.7	4.60	3.93
Belgium	+16.2 Dec	+13.3 Sep	+2.0	0.65	0.76	−0.6	4.66	4.15
France	−56.3 Jan	−36.9 Jan	−1.3	0.65	0.76	−2.9	4.60	3.94
Germany	+263.5 Jan	+231.8 Jan	+5.2	0.65	0.76	0.6	4.60	3.76
Greece	−57.1 Dec	−48.3 Dec	−12.0	0.65	0.76	−2.7	4.60	4.42
Italy	−12.8 Dec	−45.2 Dec	−2.3	0.65	0.76	−2.6	4.60	4.35
Netherlands	+57.0 Dec	+50.1 Q3	+6.8	0.65	0.76	0.3	4.60	3.98
Spain	−136.0 Dec	−136.9 Nov	−9.1	0.65	0.76	nil	4.60	4.15
Czech Republic	+4.4 Jan	−5.4 Dec	−3.2	16.2	21.3	−2.6	4.02	4.75
Denmark	+3.4 Jan	+3.3 Jan	+1.8	4.81	5.63	2.8	5.00	4.00
Hungary	−0.2 Jan	−6.8 Q3	−5.9	167	190	−4.1	8.15	8.75
Norway	+60.8 Jan	+64.1 Q4	+15.8	5.11	6.15	17.9	6.30	4.25
Poland	−12.1 Dec	−15.5 Dec	−4.1	2.28	2.95	−1.7	6.01	6.02
Russia	+140.6 Jan	+76.6 Q4	+4.0	23.7	26.1	1.2	10.25	6.47
Sweden	+17.7 Jan	+38.1 Q4	+6.1	6.08	7.03	1.5	4.20	3.93
Switzerland	+11.6 Jan	. nil	+14.6	1.02	1.21	0.7	2.82	2.96
Turkey	−64.5 Jan	−38.0 Dec	−7.7	1.22	1.42	−2.9	16.59	6.59‡
Australia	−19.7 Jan	−56.4 Q4	−5.6	1.07	1.27	1.5	8.09	6.06
Hong Kong	−23.9 Jan	+27.0 Q3	+8.8	7.79	7.82	3.1	2.14	2.50
India	−75.4 Jan	−10.9 Q3	−2.0	40.3	44.3	−3.1	7.37	7.96
Indonesia	+40.1 Jan	+10.3 Q3	+2.5	9,160	9,220	−1.8	8.11	6.62‡
Malaysia	+30.1 Jan	+28.7 Q3	+13.9	3.18	3.51	−3.1	3.62	3.24‡
Pakistan	−16.9 Feb	−8.4 Q4	−6.9	62.8	60.7	−5.1	10.04	9.89‡
Singapore	+34.5 Jan	+39.1 Q4	+25.3	1.39	1.53	nil	1.31	2.09
South Korea	+8.8 Feb	+3.8 Jan	+0.5	971	946	0.2	5.18	5.28
Taiwan	+15.7 Feb	+31.7 Q4	+5.0	30.7	33.0	−1.6	2.60	2.32
Thailand	+10.9 Jan	+15.0 Jan	+2.2	31.6	33.1	−2.1	3.27	3.79
Argentina	+11.9 Jan	+6.8 Q3	+2.0	3.15	3.10	1.2	10.31	na
Brazil	+36.5 Feb	−1.2 Jan	−0.4	1.68	2.11	−1.8	11.18	6.16‡
Chile	+23.0 Feb	+6.7 Q3	+3.8	432	540	5.4	6.48	3.92‡
Colombia	−0.8 Dec	−5.2 Q3	−4.3	1,851	2,209	−1.6	9.21	5.83‡
Mexico	−11.6 Jan	−7.4 Q4	−1.5	10.8	11.2	nil	7.45	7.51
Venezuela	+23.7 Q4	+20.0 Q4	+4.7	4.25	4.23§	−2.6	12.44	6.55‡
Egypt	−20.5 Q4	+0.5 Q1	+0.9	5.46	5.70	−7.0	4.91	4.96‡
Israel	−10.7 Jan	+5.0 Q4	+1.3	3.46	4.21	−1.4	3.42	5.08
Saudi Arabia	+146.4 2007	+98.9 2006	+22.8	3.75	3.75	12.8	2.95	na
South Africa	−10.0 Jan	−19.9 Q3	−8.0	7.83	7.48	0.6	11.40	9.12
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Estonia	−4.5 Dec	−3.4 Dec	−13.1	10.1	11.8	0.6	6.35	na
Finland	+12.2 Dec	+11.3 Dec	+3.8	0.65	0.76	3.6	4.49	3.93
Iceland	−1.2 Jan	−3.2 Q4	−11.1	68.9	67.3	3.1	13.81	na
Ireland	+36.5 Dec	−11.1 Q3	−3.8	0.65	0.76	−0.5	4.60	4.13
Latvia	−7.2 Jan	−6.4 Dec	−17.3	0.45	0.54	1.0	6.27	na
Lithuania	−7.3 Jan	−5.6 Jan	−13.5	2.23	2.61	−0.6	4.79	na
Luxembourg	−6.1 Dec	+4.7 Q3	na	0.65	0.76	nil	4.60	na
New Zealand	−3.6 Jan	−10.2 Q3	−7.4	1.24	1.45	3.8	7.35	6.35
Peru	+8.3 Jan	+1.5 Q4	−0.2	2.81	3.18	1.0	5.20	na
Philippines	−5.0 Dec	+5.8 Sep	+4.6	41.3	48.7	−0.2	6.56	na
Portugal	−26.6 Dec	−21.0 Dec	−8.1	0.65	0.76	−2.6	4.60	4.20
Slovakia	−0.9 Jan	−0.5 Nov	−2.8	20.9	25.7	−2.3	4.18	4.29
Slovenia	−3.1 Jan	−2.2 Dec	−2.5	0.65	0.76	−0.8	na	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

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Markets

Mar 13th 2008
From The Economist print edition

Markets

	Index Mar 12th	% change on one week	% change on Dec 31st 2007 in local currency	% change on Dec 31st 2007 in $ terms
United States (DJIA)	12,110.2	–1.2	–8.7	–8.7
United States (S&P 500)	1,308.8	–1.9	–10.9	–10.9
United States (NAScomp)	2,243.9	–1.3	–15.4	–15.4
Japan (Nikkei 225)	12,861.1	–0.9	–16.0	–8.3
Japan (Topix)	1,255.1	–0.7	–14.9	–7.2
China (SSEA)	4,270.2	–5.2	–22.7	–20.5
China (SSEB, $ terms)	296.9	–5.4	–21.1	–18.9
Britain (FTSE 100)	5,776.4	–1.3	–10.5	–9.2
Canada (S&P TSX)	13,297.4	–2.2	–3.9	–4.1
Euro area (FTSE Euro 100)	1,150.1	–1.2	–16.4	–11.4
Euro area (DJ STOXX 50)	3,647.6	–1.0	–17.1	–12.1
Austria (ATX)	3,776.6	+0.1	–16.3	–11.3
Belgium (Bel 20)	3,743.9	+0.2	–9.3	–3.9
France (CAC 40)	4,697.1	–1.2	–16.3	–11.3
Germany (DAX)*	6,599.4	–1.3	–18.2	–13.3
Greece (Athex Comp)	4,045.2	–0.2	–21.9	–17.2
Italy (S&P/MIB)	32,518.0	–2.8	–15.7	–10.6
Netherlands (AEX)	439.8	–1.0	–14.7	–9.6
Spain (Madrid SE)	1,421.9	+1.2	–13.4	–8.2
Czech Republic (PX)	1,523.2	+0.8	–16.1	–5.6
Denmark (OMXCB)	398.5	–2.6	–11.2	–5.9
Hungary (BUX)	22,505.5	–1.8	–14.2	–11.3
Norway (OSEAX)	480.4	–2.4	–15.7	–10.5
Poland (WIG)	47,624.2	+1.8	–14.4	–7.6
Russia (RTS, $ terms)	2,079.7	+1.8	–12.1	–9.2
Sweden (Aff.Gen)	302.6	–0.4	–11.1	–5.5
Switzerland (SMI)	7,245.0	–1.3	–14.6	–5.4
Turkey (ISE)	44,248.2	+1.8	–20.3	–23.6
Australia (All Ord.)	5,334.1	–2.5	–16.9	–11.3
Hong Kong (Hang Seng)	23,422.8	+1.3	–15.8	–15.7
India (BSE)	16,128.0	–2.5	–20.5	–22.3
Indonesia (JSX)	2,556.2	–3.2	–6.9	–4.5
Malaysia (KLSE)	1,232.6	–3.7	–14.7	–11.4
Pakistan (KSE)	15,171.4	+1.4	+7.8	+5.7
Singapore (STI)	2,917.9	+0.2	–15.8	–12.5
South Korea (KOSPI)	1,658.8	–1.1	–12.6	–15.7
Taiwan (TWI)	8,435.3	–0.6	–0.8	+4.8
Thailand (SET)	827.0	+0.2	–3.6	+2.8
Argentina (MERV)	2,134.1	–2.2	–0.8	–0.9
Brazil (BVSP)	62,176.0	–3.8	–2.7	+3.0
Chile (IGPA)	13,205.7	+1.7	–6.2	+8.1
Colombia (IGBC)	9,212.4	+2.3	–13.9	–6.1
Mexico (IPC)	29,283.4	nil	–0.9	+0.4
Venezuela (IBC)	35,280.9	+1.1	–6.9	–58.6
Egypt (Case 30)†	11,546.1	+1.3	+10.3	+11.4
Israel (TA-100)	978.5	–3.2	–15.2	–5.7
Saudi Arabia (Tadawul)	9,891.8	–0.9	+24.7	+24.7
South Africa (JSE AS)	30,710.5	+0.6	+6.1	–7.5
Europe (FTSEurofirst 300)	1,284.8	–1.3	–14.7	–9.6
World, dev'd (MSCI)	1,430.9	–1.0	–9.9	–9.9
Emerging markets (MSCI)	1,131.2	–1.0	–9.2	–9.2
World, all (MSCI)	363.5	–1.0	–9.9	–9.9
World bonds (Citigroup)	788.1	+1.6	+7.9	+7.9
EMBI+ (JPMorgan)	434.7	–0.2	+0.3	+0.3
Hedge funds (HFRX)	1,309.8	–1.1	–1.5	–1.5
Volatility, US (VIX)	27.2	24.6	22.5	(levels)
CDSs, Eur (iTRAXX)†	110.9	nil	+213.5	+232.2
CDSs, N Am (CDX)†	186.6	+8.3	+135.2	+135.2
Carbon trading (EU ETS) €	21.9	+3.1	–1.5	+4.4

*Total return index. †Credit-default swap spreads, basis points.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CME; Danske Bank; FEX; HKMA; Markit; Standard Bank

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Iceland

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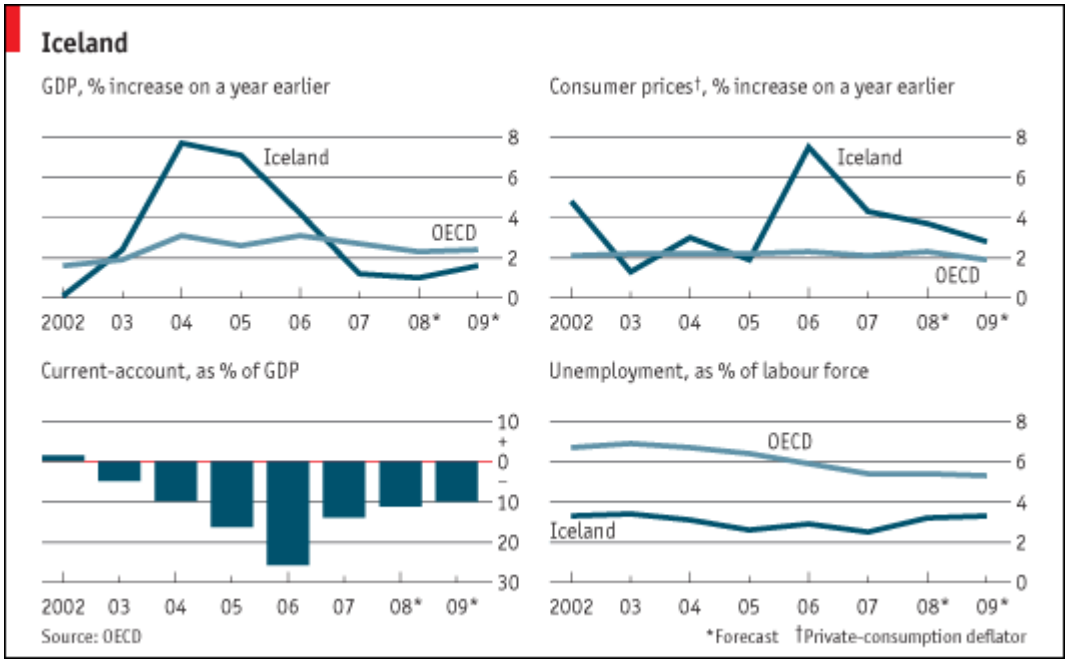

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